

Over a third of UK sourced defence contracts may be recovered by the Treasury in tax revenue

The UK government recovers over 35 per cent of the value of domestically sourced defence contracts in the form of taxation, revenue that would otherwise be lost to another government by buying foreign 'off-the-shelf' defence equipment according to a new briefing from the Royal United Services Institute (RUSI).

The Destinations of the Defence Pound, written by Dr John Louth and Professor Trevor Taylor, considers the value for money in defence contracting, drawing particular attention to the tax revenues associated with British supply chain, compared with buying equipment from overseas. Using a CIMA approach, a clear methodology and explicit assumption, the study tracks the tax revenues associated with an actual £1 million contract, and concludes that the government could get back over 28 per cent in income tax and national insurance payments alone.

The paper also suggests if the UK spends a third of its defence budget on off-the-shelf foreign systems, as outlined in the Green Paper on Equipment, Support and Technology, the Treasury would lose about £1 billion in revenue, which could have a negative effect on government revenues and thus the public sector deficit. 'If the UK government spends money on a UK contractor with a largely British supply chain, the great majority of that tax paid will flow back to the British Government, whereas money spent with an overseas supplier does not. Instead it becomes a source of tax revenue for another government.'

'Money spent on off-the-shelf foreign systems, such as the C17 and Rivet Joint, means that the government is foregoing significant tax revenues which it would have received had it expended the money involved on equipment developed and produced in the UK,' Louth and Taylor write.

The Destinations of the Defence Pound stresses calculations about tax revenues from UK companies and their employees should be a considered by the Ministry of Defence with particular defence contracts, so long as the budget deficit is viewed as such a significant challenge. 'At the end of August 2011, the government announced an order for fourteen Chinook helicopters from Boeing, at a cost of £1 billion, which was fully in line with the approach outlined above. At the beginning of October, Agusta-Westland announced that it would make 375 staff redundant because of shortages of work.' 'If the UK moves to spending even a third of its capital spending on off-the-shelf foreign systems that would represent about £1 billion less revenue for the Treasury than might have been the case.'

'Taken together, corporation tax, personal taxation, National Insurance and VAT are powerful instruments in retaining monies under the Exchequer's control in a closed-loop financial merry-go-round between government and the UK defence industry.'

The study does take account of the UK's European Union public procurement commitments and opportunities, which clearly are supposed to provide reciprocal access to others' markets, and of the Government's formal direction in the Green Book on public procurement.

The Briefing Paper The Destination of the Defence Pound can be viewed at
http://www.rusi.org/downloads/assets/Destination_of_the_Defence_Pound.pdf

Dr John Louth is Deputy Head of the RUSI Defence, Industries and Society Programme who has served as a RAF officer for sixteen years before working as a consultant and a programme director throughout the defence sector auditing and managing aspects of the UK strategic deterrent.

Professor Trevor Taylor is the head of the Defence, Industries and Society Programme and the Professorial Research Fellow in Defence Management, augmenting the Institute's work on UK Defence Policy as well as giving particular high level expertise in defence management issues.