

Comment: Cost Growth and Cancellation

In the UK, programmes are rarely, if ever, cut when their costs increase substantially – more usually they are slipped and slipped again, thereby not only risking obsolescence but ensuring further cost increases. It is a strange fact that, although it is well known that delay costs large sums of money, MoD tries to ‘save’ money by repeated delay. In the US, the Nunn–McCurdy Amendment calls for the termination of programmes when the total costs reach 25% more than the original estimate. Would such a rule work in UK? The Minister for Defence Equipment and Support thinks so.

From: John Dowdy
 Partner McKinsey & Co

In an interview with the *Financial Times* on 13 August, Quentin Davies, Minister of State for Defence Equipment and Support at the MoD, observed that “Britain can ‘absolutely afford’ its entire defence equipment programme in spite of the poor public finances, but officials must presume projects that overrun are ‘automatically cancelled’”.¹ He went on to say that he had “reversed the onus of proof so that programmes missing key milestones would be cut unless a strong case is made.”

The concept of imposing mandatory justification for programmes breaching certain milestones is not a new one. US Senator Sam Nunn and Congressman Dave McCurdy created the so-called Nunn-McCurdy Amendment in the 1982 Defence Authorisation Act. The amendment, which was subsequently made permanent in 1983, requires notification and information about possible alternatives at the 15% cost growth mark, and calls for the termination of programmes whose total costs grow by more than 25% over the original estimate.

Although Davies doesn’t specify what hurdle he might wish to use in his interview with the *Financial Times*, using the 25% cost-growth hurdle from the US Nunn-McCurdy amendment would draw attention to two UK projects – the Astute Class Submarine and the Nimrod Maritime Reconnaissance and Attack Mk4 aircraft, both of which have suffered from cost growth in excess of 25%. Additional projects would hit the 15% notification requirement, specifically the T45 Destroyer, which is inching toward the 25% figure with cost growth of 23% versus the original estimate. Depending on the precise outcomes reported in the Major Projects Report for 2009, additional projects might be expected to breach the 15% or 25% benchmarks, with cost increases anticipated on the A400M and the CVF.

It is unclear how much could actually be ‘saved’ from cancelling the Astute or the Nimrod, or indeed whether they could sensibly be cancelled at all, but the Major Project Report for 2008 shows forecast cost to completion of £2587M and £2813M respectively.²

Truth be told, US projects are very rarely actually cancelled under the Nunn-McCurdy provision. Congress normally regards the explanations from the Secretary of Defense as acceptable. In fact, Congress has deemed that the six programmes that breached the threshold (the USMC H-1 upgrade program, Space Based Infrared System (SBIRS) High, MLRS Upgrade, LDP 17, Chemical Demilitarization Program, and the CH-47 Improved Cargo Helicopter) are all essential to national security. But Nunn-McCurdy reviews have led to many changes to project management, and caused at least one programme to have been redesigned with lesser capabilities after being affected by the provision.

So, if something similar to the Nunn-McCurdy amendment were enacted in the UK, it is easy to see programmes being deemed essential for national security, but would they always find that there are no programme alternatives that provide equal or greater military capability at less cost? Or that new estimates of unit cost are reasonable? Or that the management structure is adequate to manage and control unit costs? These are the questions that Nunn-McCurdy reviews routinely ask.

Perhaps Quentin Davies is on to something after all. ■

NOTES

¹ ‘Davies rejects arms spending claims’, *Financial Times*, 13 August 2009

² National Audit Office, *MoD Major Projects Report 2008*, The Stationery Office, London, 15 December 2008