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Defence Inflation: Military Labour Costs

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Abstract

Annual estimates of defence inflation have been published covering the period 2005/06 to 2010/11. This includes estimates of inflation within labour costs (both military and civilian), contract expenditure and cash office expenditure.

In recent years, the Ministry of Defence (MOD) have introduced new administrative systems for both military (Joint Personnel Administration – JPA) and civilian personnel (Human Resource Management System - HRMS). To date, estimates of inflation in civilian labour costs have utilised data from HRMS; estimates of inflation in military labour costs have not utilised data from JPA. This paper seeks to:

- i) Discuss the advantages and limitations of utilising JPA to produce estimates of inflation in military labour costs;
- ii) Describe the new methodology, which exploits the richness of JPA, for producing estimates of inflation in military labour costs from 2010/11 onwards;
- iii) Compare estimates produced for the period prior to 2010/11 with the 2010/11 estimate to quantify the impact of the new methodology.

The principle benefit of utilising JPA is the ability to account for the changing structure of the Armed Forces between years, i.e. the impact of personnel joining or leaving the Department, or progressing up the pay scales. This will be of utmost importance in future years as the structure of the Armed Force changes towards that envisaged as Future Force 2020 (Cabinet Office, 2010).

Due to availability of historic JPA data it is only possible to directly compare estimates of the new methodology with those of the previously used methodology for 2010/11. The overall estimate of inflation in military labour cost inflation for 2010/11 under the new methodology is 4.9% (Table 10). This paper explains that methodological changes add about 0.4 percentage points to this overall 2010/11 estimate.

Note - Since the publication of the Defence Inflation: Military Labour Costs Statistical Bulletin No. 12 in September 2011, revisions have been made to the military labour cost inflation estimates. These revisions are indicated with an ‘r’ marker.

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Introduction

1. Aim

1.1 This paper outlines the latest improvements and developments towards estimating defence inflation, and more specifically, inflation within military labour costs. It outlines what steps have been taken towards improving the rigour and relevance of the military labour cost inflation estimates.

2. Objectives

2.1 Following publication of defence inflation estimates for 2009/10 in September 2010, DASA initiated a project to assess the feasibility of utilising data from the Joint Personnel Administration (JPA) system to improve estimates of inflation within military labour costs.

2.2 This project had several objectives:

i) To ensure estimates of inflation within military labour costs, and specifically military pay, captured the impact of personnel joining or leaving the Department, and personnel progressing up the pay scales.

ii) To enable more reliable comparisons between estimates of inflation in military and civilian labour costs.

iii) To ensure, to the extent practicable and appropriate, the effects of changes in quantity and 'quality' of personnel employed are differentiated from the effects of inflation.

iv) To develop a process which provides a practical and fair measure of inflation within military labour costs.

v) To present a clear distinction between inflation within military labour costs and the Military Salaries Index (MSI).

3. Background

Defence Inflation

3.1 Prior to 2001 the Ministry of Defence (MOD) published two measures of defence inflation: one was the product of the Financial Planning Forecast of Outturn process; and the second was produced by categorising all MOD expenditure by Standard Industrial Classification and assigning a relevant official price index. The first method

was abandoned in 2001 with the introduction of Resource Accounting and Budgeting, whilst the second method ceased in 2003 following an internal rebasing exercise.

3.2 In 2007 MOD initiated a programme to develop and publish a robust measure of defence inflation. The first estimates, covering the period 2005/06 to 2008/09, were published in March 2010. Further estimates were published in September 2010, which extended the period of coverage to 2009/10.

Defence Inflation: Military Labour Costs

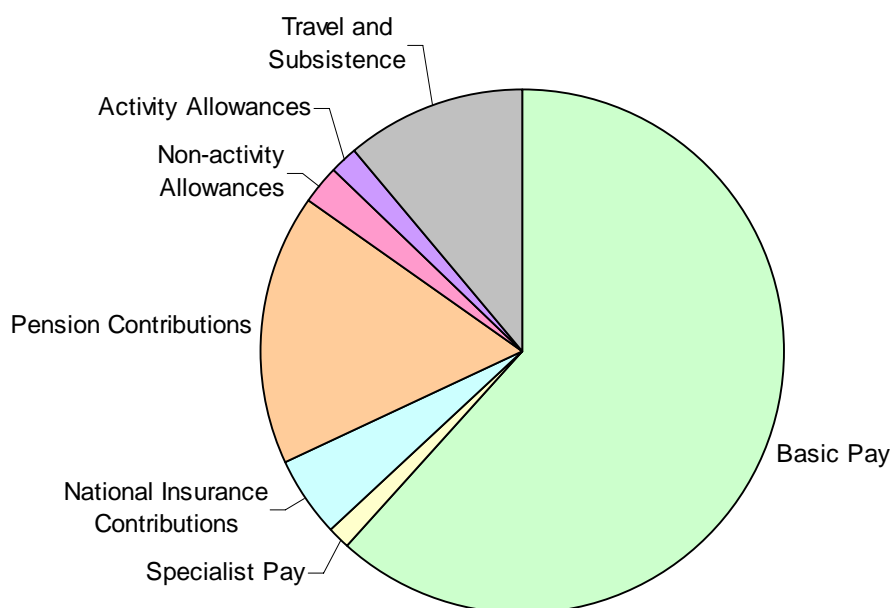
3.3 Alongside top level estimates of defence inflation, MOD also published estimates of inflation in contract expenditure, expenditure on military and civilian labour costs, and in cash office expenditure. This paper focuses on recent developments aimed at improving the rigour and relevance of the military labour cost inflation estimates.

3.4 To estimate inflation in military labour costs, expenditure on military personnel has been partitioned into seven components. Different methodologies are applied to each component as a result of the unique characteristics of each. These components are:

- i) Basic Pay;
- ii) Specialist Pay;
- iii) Activity Allowances;
- iv) Non-activity Allowances;
- v) Employer National Insurance contributions;
- vi) Employer Pension contributions;
- vii) Travel and Subsistence.

3.5 Figure 1 presents the proportion of expenditure spent on each of these components in 2009/10. About 63% of expenditure was on military basic and specialist pay (£6.5 billion), 17% on employer pension contributions (£1.7 billion), 11% on travel and subsistence (£1.1 billion), 5% on employer National Insurance contributions (£0.5 billion) and a further 4% on military allowances (£0.5 billion).

Figure 1 Military Labour Cost Expenditure by Component, 2009/10



3.6 For the period 2005/06 to 2009/10, DASA published estimates of inflation for most of these components (Table 1). Most notably, a separate estimation of inflation in pay and allowances for reservists and cadets was produced.

Table 1 Defence Inflation – Military Labour Costs, 2005/06 to 2009/10

Military Labour Costs ¹	Weights ²	Growth Rate ³				
		2005/06	2006/07	2007/08	2008/09	2009/10
Salaries	620	3.0%	3.1%	3.6%	3.7%	2.8%
Non-activity Allowance	25	-2.7%	9.2%	36.2%	-11.4%	12.1%
Activity Allowance	18	5.0%	7.5%	14.2%	2.6%	1.8%
Reservists & Cadets	19	3.0%	3.1%	3.9%	3.6%	2.8%
Pay and Allowances	682	2.9%	3.3%	4.9%	3.0%	3.1%
Travel and Subsistence	112	2.4%	2.7%	3.2%	5.4%	3.7%
National Insurance Contributions	51	2.6%	5.4%	4.0%	1.5%	2.5%
Pension Contributions	154	18.1%	3.1%	3.6%	3.8%	10.7%
Military Labour Costs	1,000	5.0%	3.3%	4.5%	3.3%	4.3%

[1] Data from 2005/06 to 2009/10 have been revised since their original publication in March 2010 and September 2010.

[2] These weights apply to the 2009/10 measure. Due to chain-linking, weights reflect the expenditure pattern within the base year, not the reference year e.g. for the 2009/10 inflation measure weights reflect expenditure in 2008/09.

[3] Growth rates are year-on-year and calculated from unrounded data.

3.7 Between 2005/06 and 2009/10 labour cost inflation averaged 4.1%, ranging from 3.3% to 5.0%. Although expenditure on allowances only accounts for about 5% of expenditure, it had a significant impact on estimates of defence inflation because of the volatility of estimates over this period.

Military Labour Cost Inflation: The Previous Methodology

3.8 Inflation in military salaries was derived from the Military Salaries Index (MSI), which is published in Chapter Two of UK Defence Statistics (DASA, 2010). Over the period 2004/05 to 2008/09, the MSI was estimated assuming that the distribution of regular Armed Forces personnel, by rank and incremental scale point is constant, over time. Utilising recommendations from the Armed Forces' Pay Review Body (AFPRB, 2010), average salaries by rank and incremental scale point are compared between years.

The **Armed Forces' Pay Review Body (AFPRB)** provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration and charges for members of the Naval, Military and Air Forces of the Crown.

In reaching its recommendations, the Review Body takes into account the following considerations:

i) The need to recruit, retain and motivate suitably able and qualified people taking account of the particular circumstances of Service life;

ii) Government policies for improving public services, including the requirement on the Ministry of Defence to meet the output targets for the delivery of departmental services;

iii) The funds available to the Ministry of Defence as set out in the Government's departmental expenditure limits;

iv) The Government's inflation target.

3.9 One principle limitation of this approach is the assumption that the distribution of personnel remains constant. This takes no account of personnel joining, leaving or progressing up the pay scale. This assumption limits the comparability of historic estimates of inflation in military and civilian labour costs.

3.10 A further limitation of this methodology is the underlying composition of the MSI cohort: regular Armed Forces personnel, excluding Gurkhas and reservists. Although estimates of inflation for reservists and cadets are published, these are based on estimates derived from the MSI, so do not account for differences between the composition of the regular and reserve Armed Forces.

4. Military Labour Cost Inflation: Developing a New Methodology

Methodology Overview

- 4.1 Between April 2006 and April 2007, MOD introduced the Joint Personnel Administration (JPA) system to each of the three services. This replaced three separate administration systems which were primarily paper based, enabling joined up functionality for numerous processes, including checking postings and payslips.
- 4.2 Since 2006, Defence Analytical Services and Advice (DASA) have been working closely with the Service Personnel and Veterans Agency (SPVA), to ensure robust statistical analysis can be presented based on data from JPA. The output from much of this work is published in DASA's Tri Service Publications, which present information on Armed Forces strengths, outflows and inflows, for a range of different groups within the Armed Forces.
- 4.3 DASA have access to JPA payment data of suitable quality for statistical purposes only from April 2009 onwards. Therefore, DASA were unable to utilise JPA pay data for estimates of military labour cost inflation produced for the periods 2005/06 to 2009/10¹.
- 4.4 JPA payment data can now be exploited to provide estimates of inflation in a range of components of military labour costs. This, coupled with consistent data on distributions of Armed Forces strengths, outflows and inflows, has enabled estimates of inflation in military labour costs to be produced which are comparable with estimates of inflation in civilian labour costs.

The Challenge

- 4.5 JPA is a rich data source, storing a vast array of payment level information. The methodology presented in this paper shows JPA can be utilised to assess the inflationary implications of individuals joining or leaving the Department, or progressing up the pay scales.

¹ 2009/10 estimates required data for both 2008/09 and 2009/10.

- 4.6 Although this richness brings many opportunities, it also presents many challenges. Each month, JPA contains about 12 million records relating to military payments. Many of these relate to the components of military labour costs we are interested in. Others contain information on days worked, breakdowns of the payment (such as amount paid in X-Factor) or supplementary information (such as the incremental pay scale point). To produce robust estimates, it is necessary to consider the combination of each monthly dataset, which is approximately 140 million records. This vast number of records adds levels of complexity to the computational and statistical analysis.
- 4.7 Additionally, as with most administration systems JPA contains errors and data inconsistencies. This is a particular issue when trying to match records of payments to a corresponding time period. We have implemented a raft of data validation methods to minimize potential bias and worked closely with JPA data experts across DASA and within SPVA. However, there are limitations: the data, even following validation, is not necessarily error-free.
- 4.8 *Note* - Since the publication of the Defence Inflation: Military Labour Costs Statistical Bulletin No. 12 in September 2011, revisions have been made to the military labour cost inflation estimates. These revisions are indicated with an 'r' marker.

Estimating Military Labour Cost Inflation

5. Cohort of Military Personnel

Previous Methodology

- 5.1 Inflation in military salaries was derived from the Military Salaries Index (MSI), which is published in Chapter Two of UK Defence Statistics (DASA, 2010). The MSI is based on the regular Armed Force, and excludes Gurkhas and reservists. For estimates of defence inflation between 2005/06 and 2009/10 the MSI was based on the structure of the regular Armed Force at 1 March 2008.
- 5.2. The historic estimates of military labour cost inflation were supplemented by separate inclusion of inflation rates for payments to reservists and cadets. Inclusion of these rates was based on total expenditure on reservists as recorded within the MOD's accounts (Consolidated Set of Books).

New Methodology

- 5.3 During 2009/10, approximately 283,000 individuals were in receipt of the payments relating to the approximate 140 million JPA records. These include regular personnel, Gurkhas, volunteer reserves, full time reserve service and cadet force adult volunteers (these groups are known as assignment types on JPA). This differs from the strengths presented in DASA's Tri Service publications (DASA, 2009) since these present strengths as a snapshot at a particular point in time, as opposed to all personnel who are recorded on JPA at least once during 2009/10.
- 5.4 All 283,000 individuals are included within the new analysis unless information about their assignment type or NATO rank is missing. In 2009/10, less than 1.2% of individuals (just over 3,000) were excluded due to missing information.
- 5.5 To estimate inflation within military labour costs, individuals are assigned to one of approximately 150 groups. These groups are based on NATO rank, assignment type and pay scale (which determines whether an individual is paid for specialist skills). Homogenous groups based on similar demography are used, since not all individuals can be tracked between years, i.e. some individuals join the Department whilst others leave. Calculating average rates of inflation for homogenous groups containing 'similar'

individuals ensures we can account for personnel joining and leaving. Annex A provides more detail on these groups.

- 5.6 Assignment type enables differentiation between regular Armed Forces personnel and other personnel, including reservists and cadets, whilst pay scale enables differentiation between personnel who are paid for particular specialist skills (such as medical staff, pilots and Special Forces personnel) and those who are not. In 2009/10, about 73% of military personnel were regulars on the main MOD pay scales; just fewer than 20% of MOD personnel in receipt of basic pay were non-regulars on the main MOD pay scales. A further 7% of MOD personnel were paid on specialist pay scales.

Comparison of Methodologies

- 5.7. The principle differences between the previous cohort and the new cohort are:
- i) The new cohort consists of all personnel in receipt of payments from the Department, whilst the previous cohort solely included regular personnel.
 - ii) The new cohort is based on the structure of the Armed Forces during the year in question, whilst the previous cohort was based on the structure at 1 March 2008.

6. Basic Pay

- 6.1 Previously estimates of inflation in military labour costs included a measure of inflation in salaries. This was based on the Military Salaries Index (MSI), i.e. expected salaries of individuals, as per recommendations of the AFPRB, assuming strengths are constant as at 1 March 2008. Going forward it will be possible to estimate inflation in actual basic pay based on the composition of the Armed Forces in the base year.

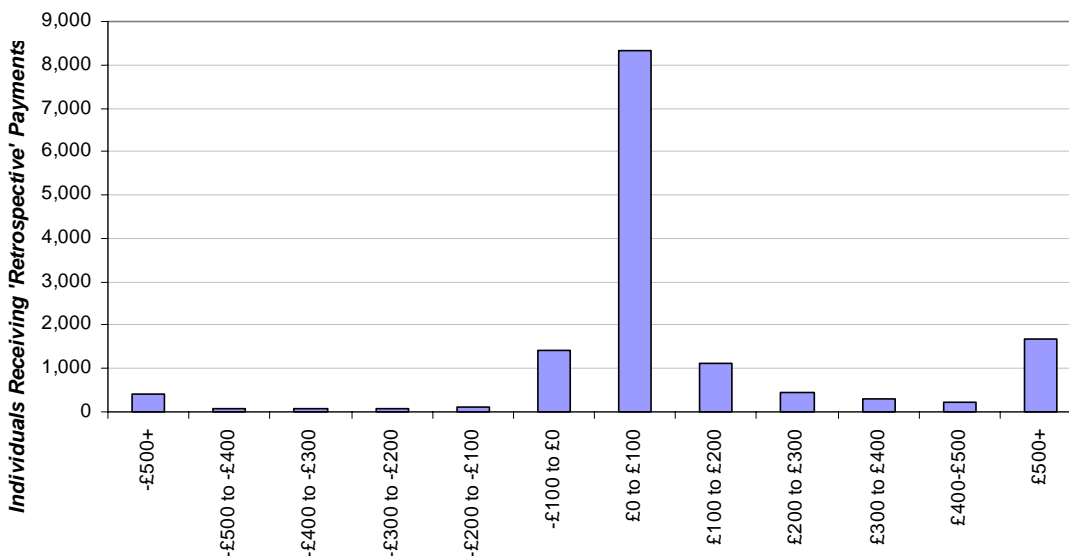
Previous Methodology

- 6.2 Inflation in military salaries was derived from the MSI. The MSI is based on the regular Armed Force, and excludes Gurkhas and reservists. For estimates of defence inflation between 2005/06 and 2009/10 the MSI was based on the structure of the regular Armed Force at 1 March 2008.
- 6.3 Inflation in salaries for reservists and cadets was calculated separately, and combined with inflation in allowances and specialist pay.

New Methodology

- 6.4 Within the 140 million JPA pay records, approximately 32 million relate to basic pay. Basic pay can broadly be defined within two categories: standard basic pay and non-standard basic pay. Standard basic pay consists of pay for officers or other ranks within the three services. Non-standard basic pay consists of pay to individuals for taking part in reservist training.
- 6.5 For the benefit of estimating inflation in military labour costs, standard and non-standard basic pay are considered separately. Different methodologies are applied because records for each type of basic pay are stored differently within JPA.
- 6.6 In addition to payments relating to current standard and non-standard basic pay, JPA also contains a significant number of 'retrospective' payments associated with both types of basic pay – about 2 million in total. 'Retrospective' basic pay records rectify earlier over or under-payments. However, these may include payments which were not actually paid to an individual. Instead, they are recorded in order to rectify an administrative error and ensure an individual's overall record is correct.
- 6.7 During June 2010, the majority (76%) of retrospective payments were between -£100 and £200 in value (Figure 1). However, for some individuals there are records totalling over £40,000 in one month.

Figure 2 Distribution of 'Retrospective' Basic Pay, June 2010



6.8 If included, these large ‘retrospective’ payments would have a significant impact on inflation estimates. Since they may include JPA system corrections along with payments from different periods they have been excluded. Inclusion of ‘retrospective’ payments between -£500 and £500 has minimal impact on results. Therefore, all ‘retrospective’ payments associated with basic pay have been excluded.

Comparison of Methodologies

6.9 Table 2 presents a comparison of inflation in salaries/basic pay between 2005/06 and 2010/11 for the two different methodologies.

Table 2 Defence Inflation – Military Salaries, 2005/06 to 2010/11

	Growth Rate ¹					
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Salaries - Previous Methodology ²	3.0%	3.1%	3.6%	3.7%	2.8%	2.0%
Basic and Specialist Pay - New Methodology						2.8% r

[1] Growth rates are year-on-year and calculated from unrounded data.

[2] Data from 2005/06 to 2008/09 have been revised since their original publication in March 2010 and September 2010.

[r] Indicates a change to figures previously published in the 2010/11 military labour costs statistical bulletin.

6.10 Between 2005/06 and 2009/10, estimates of inflation in military salaries (under the previous methodology) ranged from 2.8% to 3.7%. The estimate of inflation in military salaries (under the previous methodology) was 2.0% in 2010/11. Utilising the new methodology, estimates of inflation in basic pay in 2010/11 were 0.8 percentage points higher.

6.11 The three principle differences between the previous methodology and the new methodology are:

- i) The new methodology results in an estimate which takes into account individuals joining, leaving and progressing up the pay scales.
- ii) The new methodology includes all individuals in receipt of basic pay, whilst the previous methodology only included regular personnel.
- iii) The new methodology is based on actual basic pay received by individuals, whilst the previous methodology was based on the salary recommendations of the Armed Forces Pay Review Body.

6.12 The main driver for the difference in the 2010/11 estimates is the development of an estimate which takes account of individuals progressing up the pay scales.

7. Specialist Pay

7.1 Specialist pay is paid to specific groups within the Armed Forces to assist with specific recruitment or retention requirements. Specialist pay rates can both increase and decrease, and can be withdrawn when the requirement for the payment ceases to exist. As with basic pay, specialist pay rates are recommended by the AFPRB and reviewed annually.

7.2 Specialist pay is paid for undertaking specific activities related to an individual's normal work such as flying, parachuting, or being in a submarine. There are a wide range of specialist pay rates dependent on the activity and an individual's experience. Usually individuals may not receive more than one form of specialist pay; however there are some exceptions.

Previous Methodology

7.3 Since specialist pay is paid to individuals for undertaking specific activities related to their normal work, an increase in the number of recipients would be associated with an increase in output. Therefore, it is important to ensure that estimates of inflation exclude the impact in changes in quantity – only increases in the actual rates of specialist pay represent inflation.

7.4 Estimates of inflation in specialist pay were based on the AFPRB recommendation that *“all rates of Specialist Pay, unless otherwise stated, be increased by 2 per cent with effect from 1 April 2010”* (AFRPB, 2010). These recommendations for individual activities are weighted together based on expenditure which was released to inform the AFPRB recommendations.

New Methodology

7.5 Ideally we would adopt a method similar to that for estimating inflation in basic pay, i.e. estimating an average rate of inflation for each of the approximately 150 groups. However, this approach was not practical because of the wide range of different specialist pay rates, both for undertaking different activities and for differing levels of

experience. In 2010/11 there were at least 22 different activities; for just Special Pay (Flying) there were 180 different rates.

7.6 Therefore, as with the previous methodology, estimates of inflation in specialist pay are based on the AFPRB recommendations. However, these recommendations for individual activities are weighted together based on expenditure recorded on JPA.

Comparison of Methodologies

7.7 Estimates of inflation in specialist pay during 2010/11 are 2.0% for both methodologies. All of the activities considered had an inflation rate of 2.0%, so different weights would have no impact.

7.8 Table 3 presents total departmental expenditure on specialist pay for six of the activities considered. Expenditure recorded on JPA for 2009/10 (which was used for the 2010/11 inflation measure) was similar to that previously used to inform the AFPRB. For each of the six activities presented below, expenditure recorded on JPA for 2009/10 was within 7% of that released to AFPRB for 2008/09. Hence, the new methodology is likely to produce similar estimates to the old methodology in future years, even where specialist pay for different activities have different inflation rates.

Table 3 MOD Expenditure on Specialist Pay¹, 2004/05 to 2009/10

	Expenditure (£m)					
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Flying	53.2	57.2	56.0	46.3	53.3	51.2
Submarine ²	27.3	28.0	25.7	40.6	33.5	34.6
Parachute	6.9	7.5	7.3	6.9	5.9	6.3
Diving	6.2	6.2	6.1	6.8	5.1	5.2
Mountain Leaders	0.0	0.3	0.3	0.5	0.4	0.4
Hydrographic	0.4	0.4	0.4	0.6	0.5	0.5

[1] This table does not cover expenditure on all specialist pay activities.

[2] Includes submarine supplement and nuclear propulsion pay.

8. Military Allowances

8.1 Military allowances are categorized as one of two types: activity related or non-activity related. Under both the new and previous methodologies they are analysed separately.

8.2 **Activity related allowances** are awarded to individuals being asked to perform activities different from their standard activities. Activity related allowances include Operational Allowance, Longer Separation Allowance and Language Awards.

8.3 **Non-activity related allowances** include Continuity of Education Allowance, and Committal and Retention Allowances. Increases in either the value of these allowances or the number of recipients would not be associated with a change of output.

9. Activity Related Allowances

Previous Methodology

9.1 Estimates of inflation were produced for three activity related allowances². Increases in the number of recipients of activity related allowances are associated with an increase in output. Only increases in the actual value of activity related allowances constitute inflation.

9.2 To estimate inflation in activity related allowances, changes in the actual rates of allowances between one year and the next, as recorded in the MOD's HR document JSP 752 (MOD, 2010), are weighted together. This is based on expenditure as recorded in the MOD's accounts (Consolidated Set of Books).

New Methodology

9.3 Expenditure recorded in the MOD's accounts for each activity allowance should be consistent with that paid through JPA. Table 4 presents a comparison of expenditure recorded in MOD's accounts and JPA expenditure for each of the three activity related allowances analysed. JPA expenditure on these activity related allowances was very similar to that recorded in MOD's accounts for 2009/10.

Table 4 Activity Related Allowances - Expenditure, 2009/10

	CSoB¹ (£m)	JPA (£m)	Difference (%)
Operational Allowance	62.5	62.5	-0.1%
Longer Separation Allowance	113.9	113.7	-0.2%
Language Awards	1.5	1.5	0.0%

[1] Consolidated Set of Books.

² Operational Allowance; Language Awards; Longer Separation Allowance.

- 9.4 The aim of the Operational Allowance is to recognise the significantly increased danger associated with specific operational locations. There is one daily rate which is usually reviewed annually. However, during 2010/11 the daily rate was uplifted twice; from £13.08 to £14.51 in April 2010, and to £29.02 in May 2010.
- 9.5 The aim of the Longer Separation Allowance is to support retention of personnel experiencing separation. Personnel are compensated at one of fourteen levels dependent on the duration of the separation. Rates at each level are reviewed each April e.g. at April 2010 the rate paid at each level was uplifted by 2%. Annex B provides detailed rates for each level in 2009/10 and 2010/11. Since movements from one level to another are governed by duration of separation rather than any change in Departmental output, changes in payments due to these movements constitute inflation.
- 9.6 The aim of the Language Awards is to encourage Service personnel to obtain competences in languages related to the needs of the Service. JPA payments cover two schemes: the Defence Basic Language Award Scheme (BLAS) and the Defence Operational Language Award Scheme (DOLAS). Both of these schemes have a range of rates dependent on the specific language and level of capability (Annex B). Since the introduction of these schemes, rates have not been uplifted.

Comparison of Methodologies

- 9.7 Estimates of inflation in expenditure on the **Operational Allowance** were previously based on the change in the daily rate paid as published in JSP 752 (MOD, 2010). The new method utilises actual expenditure as recorded on the JPA database, attributing average rates to each of the homogenous groups presented in Annex A. Table 5 presents a comparison of the inflation rates between the new and the previous methodologies for each activity allowance in 2010/11.

Table 5 Inflation in Expenditure on Activity Allowances, 2010/11

	Growth Rate ¹	
	New Methodology	Previous Methodology
Activity Allowances	32.4% r	40.9%
Operational Allowance	86.5% r	112.6%
Longer Separation Allowance	3.1% r	2.0%
Language Awards	0.0%	0.0%

[1] Growth rates are year-on-year and calculated from unrounded data.

[r] Indicates a change to figures previously published in the 2010/11 military labour costs statistical bulletin.

- 9.8 Both methodologies show very high inflation rates in expenditure on the Operational Allowance: the new methodology estimates inflation to be 86.5% compared with the previous methodology's estimate of 112.6%. These high rates reflect changes to the underlying daily rates implemented during 2010/11. The principle driver for the new methodology estimating a lower rate is that there is a delay between personnel being eligible for the new higher rate allowance and actually receiving payment.
- 9.9 Estimates of inflation in expenditure on the **Longer Separation Allowances** were previously based on the change in the daily rate paid as published in JSP 752 (MOD 2010). Under the previous methodology, inflation in expenditure on this allowance was estimated to be 2.0% (Table 5).
- 9.10 The new method utilises actual JPA expenditure, attributing average rates to each of the homogenous groups presented in Annex A. Under the new methodology, inflation within this allowance was estimated to be 3.1% (Table 5).
- 9.11 The principle reason for the new methodology estimating a higher rate is that it takes account of individuals progressing to a higher level of allowance due to longer duration of separation.
- 9.12 As discussed, the two **Language Awards** comprise a range of different payment levels dependent on the language and proficiency of the recipient. If more personnel are paid these allowances, or personnel are paid at different levels, this is associated with a change in Departmental output. Therefore, both methodologies estimate inflation based on changes to the rates for each language type and proficiency level.
- 9.13 To date, since the introduction of these awards, the rates have not changed. Hence, inflation in expenditure on Language Awards in 2010/11 is 0% (Table 5).

10. Non-Activity Related Allowances

Previous Methodology

10.1 Estimates of inflation in military allowances were produced for two non-activity related allowances³.

10.2 Changes in either the value or number of recipients of non-activity related allowances are not associated with a change of output. Therefore, estimates of inflation in non-activity related allowances were considered equal to the changes in gross expenditure for each allowance, as recorded in the MOD's accounts.

New Methodology

10.3 Expenditure recorded in MOD's accounts for both non-activity related allowances should be consistent with that paid through JPA. Table 6 presents a comparison of expenditure recorded in MOD's accounts and JPA expenditure for both allowances.

Table 6 Non-Activity Related Allowances - Expenditure, 2009/10

	CSoB¹ (£m)	JPA (£m)	Difference (%)
Continuity of Education Allowance	180.7	115.7	-36%
Committal and Retention Allowance	95.0	80.5	-15%

[1] Consolidated Set of Books.

10.4 However, differing terminologies used within JPA and MOD's accounts for non-activity related allowances hindered comparisons.

10.5 Given the differing terminologies, to ensure consistency with expenditure recorded within MOD's accounts the new methodology adopted the same approach as the previous methodology, i.e. inflation in non-activity allowances is assumed to equal the difference in gross expenditure as recorded in MOD's accounts.

Comparison of Methodologies

10.6 Both methodologies adopt the same approach for estimating inflation in the two key non-activity allowances. Namely, the change in gross expenditure as recorded in MOD's

³ Continuity of Education Allowance; Committal and Retention Allowance.

accounts. Table 7 presents the inflation rates for both non-activity allowances in 2010/11.

Table 7 Inflation in Expenditure on Non-Activity Allowances, 2010/11

	Expenditure (£m)		Growth Rate ¹
	2009/10	2010/11	
Non-Activity Allowances	275.7	324.5	17.7%
Continuity of Education Allowance	180.7	181.4	0.4%
Committal and Retention Allowance	95.0	143.0	50.5%

[1] Growth rates are year-on-year and calculated from unrounded data.

11. Employer National Insurance and Pension Contributions

11.1 Earnings Related National Insurance Contributions (ERNIC) are payments made by the Department to HM Revenue & Customs (HMRC), on earnings paid to employees. These payments are in addition to those National Insurance contributions made by the employee themselves. Each year HMRC review and publish ERNIC rates (HMRC, 2010); these are applicable for both military and civilian personnel. Annex C provides a summary of ERNIC rates between 2004/05 and 2010/11.

11.2 Superannuation Contribution Adjusted for Past Experience (SCAPE) is the model accepted by HM Treasury and used to charge departments for the provision of an unfunded pension scheme. Under SCAPE, both the employer and the employee make contributions to the scheme. SCAPE rates are determined by the Government's Actuary Department, reflecting their expectations of the cost of future pension provision. Different rates are applied to military and civilian personnel. Annex C provides a summary of SCAPE rates for military personnel between 2004/05 and 2010/11.

Previous Methodology

11.3 As with military salaries, inflation in both Departmental National Insurance and pension contributions was derived from the Military Salaries Index (MSI). The ERNIC and SCAPE rates were applied to the average salaries, by rank and pay scale, as recommended by AFPRB.

11.4 Previously, the main drivers of inflation within National Insurance and pension contributions were underlying changes in either the ERNIC or SCAPE rates.

New Methodology

- 11.5 Inflation in Departmental National Insurance and pension contributions is now based on estimates of standard and non-standard basic pay as per the new basic pay methodology.
- 11.6 The ERNIC rates are applied to the basic pay estimates for all Military personnel. Estimates of average National Insurance contributions are then presented for each of the approximately 150 homogeneous groups.
- 11.7 Similarly, the SCAPE rates are applied to the basic pay estimates for most Military personnel. Estimates of average pension contributions are then presented for each of the approximately 150 homogeneous groups. However, it should be noted that the Department does not make pension contributions for all personnel; some opt out. Therefore, SCAPE rates are not applied to these individuals.
- 11.8 Hence, the new methodology explicitly takes account of individuals joining and leaving the Department, or progressing up the pay scales.

Comparison of Methodologies

- 11.9 Table 8 presents a comparison of inflation in Departmental National Insurance and pension contributions for the two methodologies.

Table 8 Inflation in National Insurance and Pension Contributions, 2010/11

	Growth Rate ¹	
	New Methodology	Previous Methodology
Pension Contributions	9.4% r	8.5% r
National Insurance Contributions	3.9% r	5.5% r

[1] Growth rates are year-on-year and calculated from unrounded data.

[r] Indicates a change to figures previously published in the 2010/11 military labour costs statistical bulletin.

- 11.10 The new methodology produces higher inflation estimates for Departmental pension contributions but lower estimates for National Insurance contributions. As with estimates of inflation in basic pay, the effect of individuals progressing up pay scales leads to higher rates of inflation for both categories. However, under the previous methodology, this is offset for Departmental National Insurance contributions, by the approach used to estimate contributions related to allowance payments.

12. Travel and Subsistence

12.1 Travel and Subsistence (T&S) is paid to individuals to reimburse them for out of pocket expenses that have been incurred due to non-standard activity being undertaken. These include detached duty, staff movements and overseas allowances. Both methodologies adopt the same approach for estimating inflation in military T&S expenditure.

Methodology (Previous and New)

12.2 Previously, the method for estimating inflation in T&S utilised expenditure recorded in the MOD's accounts (Consolidated Set of Books). These accounts record T&S for a range of different activities, including personnel movement, overseas detachments, detached duty and air travel.

12.3 To distinguish inflation from changes in volume of activity, inflation in T&S is estimated by reference to relevant price indices or combinations of price indices, and where relevant, appropriate exchange rates. For example, inflation in military "messing and food" T&S was estimated as the change in the 'Retail Price Index for Food' and the 'Services Producer Price Index for Licensed Hotels'.

12.4 At present, DASA's JPA T&S payment data is not of sufficient quality to enable development of an alternative methodology. Therefore, the methodology described above has been utilised for producing 2010/11 estimates. In 2010/11, inflation in military T&S expenditure was 3.6%.

Summary

13. Overview

13.1 A measure of inflation in military labour costs has been developed exploiting the military's Joint Personnel Administration (JPA) system. This replaces the previous measure which utilised the Military Salaries Index (MSI) and expenditure from the MOD's accounts (Consolidated Set of Books).

13.2 The main drivers for developing a new measure of inflation in military labour costs are the availability of robust JPA data and the requirement to provide comparisons to inflation in civilian labour costs. Due to availability of JPA data it is not possible to produce estimates of the new measure prior to 2010/11.

13.3 This new measure takes into consideration changes in the composition of the Armed Forces, by rank and pay scale, each year. This ensures the inflationary impact of personnel joining or leaving the Department, or progressing up the pay scales, is captured.

13.4 Labour cost expenditure has been partitioned into seven categories of expenditure, with different methods applied as a result of the unique characteristics of each:

- i) Basic Pay;
- ii) Specialist Pay;
- iii) Activity Allowances;
- iv) Non-activity Allowances;
- v) National Insurance contributions;
- vi) Pension contributions;
- vii) Travel and Subsistence.

14. Results

14.1 Table 9 presents 2010/11 estimates for the two measures and historic figures for the previous methodology.

Table 9 Defence Inflation – Military Labour Costs, 2005/06 to 2010/11

	Growth Rate ¹					
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Military Labour Costs - Previous Methodology ²	5.0%	3.3%	4.5%	3.3%	4.3%	4.5% r
Military Labour Costs - New Methodology						4.9% r

[1] Growth rates are year-on-year and calculated from unrounded data.

[2] Data from 2005/06 to 2009/10 have been revised since their original publication in March 2010 and September 2010.

[r] Indicates a change to figures previously published in the 2010/11 military labour costs statistical bulletin.

14.2 The estimate of military labour cost inflation in 2010/11 using the new methodology is 0.4 percentage points higher than that estimated using the previous methodology. This difference was primarily due to differences in basic pay inflation rates, and to a lesser extent, differences in the estimate of inflation in employer pension contributions (Table 10).

Table 10 Defence Inflation – Military Labour Costs, 2010/11

Military Labour Costs	Weights	Growth Rate ¹	
		New Methodology	Previous Methodology
Basic Pay	630	2.8% r	2.0%
Non-activity Allowance	27	17.7%	17.7%
Activity Allowance	17	32.4% r	40.9%
Pay and Allowances	674	4.2% r	3.6%
Pension Contributions	166	9.4% r	8.5% r
National Insurance Contributions	51	3.9% r	5.5% r
Travel and Subsistence	110	3.6%	3.6%
Military Labour Costs	1000	4.9% r	4.5% r

[1] Growth rates are year-on-year and calculated from unrounded data.

[r] Indicates a change to figures previously published in the 2010/11 military labour costs statistical bulletin.

14.3 The main driver for the difference in the 2010/11 estimates is the development of a chain linked Laspeyres index which takes account of personnel joining and leaving the Department, and those progressing up the pay scales.

15. Strengths and Weaknesses of the New Methodology

15.1 The new methodology exploits JPA to produce estimates of inflation in many of the components of military labour costs. These include basic pay, activity allowances, employer National Insurance contributions and employer pension contributions.

15.2 JPA is a rich data source, storing a vast array of payment level information. It has enabled us to consider the inflationary implications of individuals joining or leaving

the Department, or progressing up the pay scales within the above components of labour cost expenditure.

15.3 However, although the richness of JPA brings many opportunities it also presents many complications. As with most administration systems JPA contains errors and data inconsistencies. This is a particular issue when trying to match records of payments to a corresponding time period. We have implemented a raft of data validation methods to minimize potential bias and worked closely with JPA data experts across DASA and within SPVA. However, there are limitations: the data, even following validation, is not necessarily error-free.

15.4 Although it would be preferable to produce estimates of inflation in specialist pay, non-activity allowances, and travel and subsistence using JPA this has not been possible. This is due to a combination of factors including the complexity of the MOD's pay rates (eg. the vast range of different rates for specialist pay) and the complexity and resource required to validate the data (eg. Travel and Subsistence pay records).

15.5 Finally, since estimates of military pay inflation and activity allowances account for joiners, leavers and those progressing up the pay scales, comparisons between inflation in Military and Civilian pay and allowances are far more robust than in earlier years.

Annex A: Homogenous Groups for Individuals Receiving Salary Payments, 2009/10

Pay Scale	Pay Scale Description	NATO Rank	Regular or Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR2	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR3	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR4	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR6	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR7	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR8	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR9	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF0	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF1	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF2	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF3	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF4	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF5	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF6	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF7	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF8	Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF9	Regular
2	Medical and Dental Officers	OF0	Regular
2	Medical and Dental Officers	OF1	Regular
2	Medical and Dental Officers	OF2	Regular
2	Medical and Dental Officers	OF3	Regular
2	Medical and Dental Officers	OF4	Regular
2	Medical and Dental Officers	OF5	Regular
2	Medical and Dental Officers	OF6	Regular
2	Medical and Dental Officers	OF7	Regular
2	Medical and Dental Officers	OF8	Regular
3	Chaplains	OF2	Regular
3	Chaplains	OF3	Regular
3	Chaplains	OF4	Regular
3	Chaplains	OF5	Regular
3	Chaplains	OF6	Regular
3	Chaplains	OF7	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF0	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF1	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF2	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF3	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF4	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF5	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF6	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF7	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF8	Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF9	Regular
6	Main Scale Ranks exc Nurses	OR2	Regular
6	Main Scale Ranks exc Nurses	OR3	Regular
6	Main Scale Ranks exc Nurses	OR4	Regular
6	Main Scale Ranks exc Nurses	OR6	Regular
6	Main Scale Ranks exc Nurses	OR7	Regular
6	Main Scale Ranks exc Nurses	OR8	Regular
6	Main Scale Ranks exc Nurses	OR9	Regular
7	Nurses	OR2	Regular
7	Nurses	OR3	Regular
7	Nurses	OR4	Regular
7	Nurses	OR6	Regular
7	Nurses	OR7	Regular
7	Nurses	OR8	Regular
7	Nurses	OR9	Regular
7	Nurses	OF1	Regular
7	Nurses	OF2	Regular
7	Nurses	OF3	Regular
7	Nurses	OF4	Regular
7	Nurses	OF5	Regular
9	Veterinary Staff	OF2	Regular
9	Veterinary Staff	OF3	Regular
9	Veterinary Staff	OF4	Regular
11	Special Forces Officers	OF1	Regular
11	Special Forces Officers	OF2	Regular
11	Special Forces Officers	OF3	Regular

Pay Scale	Pay Scale Description	NATO Rank	Regular or Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR2	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR3	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR4	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR6	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR7	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR8	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OR9	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF0	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF1	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF2	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF3	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF4	Non-Regular
1	Cadet Force Adult Volunteers; Apprentices; NULL	OF5	Non-Regular
2	Medical and Dental Officers	OF0	Non-Regular
2	Medical and Dental Officers	OF1	Non-Regular
2	Medical and Dental Officers	OF2	Non-Regular
2	Medical and Dental Officers	OF3	Non-Regular
2	Medical and Dental Officers	OF4	Non-Regular
2	Medical and Dental Officers	OF5	Non-Regular
3	Chaplains	OF2	Non-Regular
3	Chaplains	OF3	Non-Regular
3	Chaplains	OF4	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF0	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF1	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF2	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF3	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF4	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF5	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF6	Non-Regular
5	Main Scale Officers; Senior Officers; University Commissioned Entrants	OF7	Non-Regular
6	Main Scale Ranks exc Nurses	OR2	Non-Regular
6	Main Scale Ranks exc Nurses	OR3	Non-Regular
6	Main Scale Ranks exc Nurses	OR4	Non-Regular
6	Main Scale Ranks exc Nurses	OR6	Non-Regular
6	Main Scale Ranks exc Nurses	OR7	Non-Regular
6	Main Scale Ranks exc Nurses	OR8	Non-Regular
6	Main Scale Ranks exc Nurses	OR9	Non-Regular
7	Nurses	OR2	Non-Regular
7	Nurses	OR3	Non-Regular
7	Nurses	OR4	Non-Regular
7	Nurses	OR6	Non-Regular
7	Nurses	OR7	Non-Regular
7	Nurses	OF1	Non-Regular
7	Nurses	OF2	Non-Regular
7	Nurses	OF3	Non-Regular
7	Nurses	OF4	Non-Regular
9	Veterinary Staff	OF2	Non-Regular
9	Veterinary Staff	OF3	Non-Regular
9	Veterinary Staff	OF4	Non-Regular
11	Special Forces Officers	OF1	Non-Regular
11	Special Forces Officers	OF2	Non-Regular
11	Special Forces Officers	OF3	Non-Regular
4	Officers Commissioned from the Ranks	OR7	Combined
4	Officers Commissioned from the Ranks	OR8	Combined
4	Officers Commissioned from the Ranks	OR9	Combined
4	Officers Commissioned from the Ranks	OF1	Combined
4	Officers Commissioned from the Ranks	OF2	Combined
4	Officers Commissioned from the Ranks	OF3	Combined
8	Pilots	OR6	Combined
8	Pilots	OR7	Combined
8	Pilots	OR8	Combined
8	Pilots	OR9	Combined
8	Pilots	OF2	Combined
8	Pilots	OF3	Combined
10	Special Forces Ranks	OR2	Combined
10	Special Forces Ranks	OR3	Combined
10	Special Forces Ranks	OR4	Combined
10	Special Forces Ranks	OR6	Combined
10	Special Forces Ranks	OR7	Combined
10	Special Forces Ranks	OR8	Combined
10	Special Forces Ranks	OR9	Combined

Annex B: Defence Activity Allowance Rates, 2009/10 and 2010/11

Operational Allowance			
	2009/10	2010/11	
		April	May - March
Daily Rate	£13.08	£14.51	£29.02

Longer Separation Allowance			
	Daily Rate		
	2009/10	2010/11	Difference
Level 1	£6.56	£6.69	2.0%
Level 2	£10.25	£10.46	2.0%
Level 3	£13.96	£14.24	2.0%
Level 4	£15.32	£15.63	2.0%
Level 5	£16.50	£16.83	2.0%
Level 6	£17.68	£18.03	2.0%
Level 7	£18.84	£19.22	2.0%
Level 8	£20.62	£21.03	2.0%
Level 9	£21.80	£22.24	2.0%
Level 10	£22.99	£23.45	2.0%
Level 11	£24.16	£24.65	2.0%
Level 12	£25.34	£25.85	2.0%
Level 13	£26.51	£27.04	2.0%
Level 14	£27.69	£28.24	2.0%

Basic Language Award Scheme			
	Language Group		
	One	Two	Three
2 SLP Points	£288	£216	£144
3 SLP Points	£432	£324	£216
4 SLP Points	£576	£432	£288
5 SLP Points	£720	£540	£360
6 SLP Points	£864	£648	£432
7 SLP Points	£1,008	£756	£504
8 SLP Points	£1,152	£864	£576
9 SLP Points	£1,296	£972	£648
10 SLP Points	£1,440	£1,080	£720
11 SLP Points	£1,584	£1,188	£792
12 SLP Points	£1,728	£1,296	£864
13 SLP Points	£1,872	£1,404	£936
14 SLP Points	£2,016	£1,512	£1,008
15 SLP Points	£2,160	£1,620	£1,080
16 SLP Points	£2,304	£1,728	£1,152

Defence Operational Language Award Scheme					
	Survival	Functional	Professional	Expert	
Qualification	£1,800	£4,500	£8,100	£11,700	
Incremental Qualification	n/a	£2,700	£3,600	£3,600	
Re-qualification	£600	£1,500	£2,700	£3,900	
Non-Deployed Active Use (Daily Rate)	£3.60	£9.00	£16.20	£23.40	
Deployed Active Use (Daily Rate)	Tier One	£3.60	£9.00	£16.20	£23.40
	Tier Two	£5.40	£13.50	£24.30	£35.10
	Tier Three	£7.20	£18.00	£32.40	£46.80
	Tier Four	£9.00	£22.50	£40.50	£58.50
	Tier Five	£10.80	£27.00	£48.60	£70.20

Annex C: ERNIC and SCAPE Rates, 2004/05 – 2010/11

Earnings Related National Insurance Contributions						
	Lower Earning Limit (LEL)	Rebate (Applicable LEL to ET)	Earning Threshold (ET)	Contribution Rate (Applicable ET to UEL)	Upper Earnings Limit (UEL)	Contribution Rate (Applicable Over UEL)
2004/05	£4,108	3.5%	£4,745	9.3%	£31,720	12.8%
2005/06	£4,264	3.5%	£4,895	9.3%	£32,760	12.8%
2006/07	£4,368	3.5%	£5,035	9.3%	£33,540	12.8%
2007/08	£4,524	3.7%	£5,225	9.1%	£34,840	12.8%
2008/09	£4,680	3.7%	£5,435	9.1%	£40,040	12.8%
2009/10	£4,940	3.7%	£5,715	9.1%	£40,040	12.8%
2010/11	£5,044	3.7%	£5,715	9.1%	£40,040	12.8%

Superannuation Contribution Adjusted for Past Experience		
	Officers	Other Ranks
2004/05	33.8%	18.2%
2005/06	36.3%	21.8%
2006/07	36.3%	21.8%
2007/08	36.3%	21.8%
2008/09	36.3%	21.8%
2009/10	38.3%	23.8%
2010/11	40.1%	25.6%

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