

PREM 19/161

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PART ONE
SECRET

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Confidential Filing

The Defence Budget

DEFENCE

17 MAY 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PREM 19/161

PART 1 ends:-

TL to HMT 17-1-80

PART 2 begins:-

OD(80)3 17-1-80

Subject on
Econ Pbl Pt 7 Public Expenditure



10 DOWNING STREET

From the Private Secretary

17 January, 1980.

As you know, the Chancellor called on the Prime Minister this morning. He first reported on the public expenditure bilaterals. He was still a long way short of reaching agreement on savings which would total £1,000 million in 1980/81. It would be necessary to obtain additional savings on the housing programme over and above what the Secretary of State for the Environment seemed willing to offer; he would probably have to press for the limitation of child benefit uprating to 50p - even though this would be difficult because of the associated need to limit the uprating of the child supplement on supplementary benefit; it would probably be necessary to look for further savings from the education programme; the aid programme, and also from defence. In the latter connection, the Secretary of State for Defence had written to the Chief Secretary saying that further savings were impossible, and he (the Chancellor) was intending to reply to the effect that defence could not be immune from the latest public expenditure exercise. However, he wanted to have the Prime Minister's view on whether he should proceed in this way.

The Prime Minister said that it would be right to look for savings on the defence programme, but procedurally it would be better if the Chancellor were to see Mr. Pym - rather than write to him. She also suggested that the Home Secretary might be invited to the meeting. As regards the possible scope for savings, the Prime Minister drew the Chancellor's attention to a letter from the editor of Jane's Fighting Ships (copy enclosed). She also referred the Chancellor to briefing which Sir Derek Rayner had provided her with before her recent visit to the Ministry of Defence. (I enclose a copy of the brief; but I should emphasise that this was prepared for the personal use of the Prime Minister, and the fact that you have a copy should not be revealed to the Ministry of Defence.) - See *PM's visit to Departments Pt 2 21.12.79*

The Chancellor also reported briefly on the monetary situation. He was proposing to authorise the issue of a new tap stock the following day, in order to provide further funding

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in February - which would be the last banking month before the Budget. He was also considering with the Governor the possibility of issuing some kind of indexed stock: there was a case for considering this because of the heavy burden which the current high cost of borrowing would impose on future generations. The Prime Minister took note.

A.J. Wiggins, Esq.,
HM Treasury.

JANE'S YEARBOOKS

Mr Ian Gow TD MP
The Dog House
Hankham
Hailsham
East Sussex

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JANE'S FIGHTING SHIPS

from the Editor
Captain John E. Moore, R.N.

Elmhurst
Rickney
Nr. Hailsham
Sussex BN27 1SF, England

Telephone 0323 763 294

Your reference

our reference

date 20 December 1979

My dear Ian,

Since we last spoke about defence matters I have done a lot of listening to a lot of people - in NATO and outside; professionals, politicians, industrialists and the ordinary people who are those whose protection I believe to be the prime duty of any government in any country. I haven't worried you before because I felt that in the first six months of government you would all be looking desperately for what could be salvaged from the wreck you inherited. Now that it's apparent that the state of the British hulk is far worse than we had feared I want to suggest to you a number of areas in which I believe both savings and improvements could and should be made in my own parochial area of naval defence. I will list them as suggestions but, if you have the time and feel that they merit any further investigation, I could provide you with more detailed papers on the individual subjects. Some of these would be my own ideas, others would come from others who are not only wiser and more technically knowledgeable than I am but also equally concerned.

a) The organisation

When the Ministry of Defence was created in its present form in 1963 the Admiralty was pretty heavyweight so far as its bureaucracy was concerned. For instance, the five captains and seven commanders of Plans Division were served by three registries. But the overall command of the outfit was vested in a Board of Admiralty which, with hangers-on, was smaller than the Admiralty Board today. We have, admittedly, got rid of the Deputy Chief of Naval Staff, who was primarily concerned with Air Affairs, because we have got rid of most of the Fleet Air Arm. But we now have three Assistant Chiefs of Naval Staff instead of one in 1962.

In 1962 we still organised the "Future Size and Shape of the Fleet" by naval staff discussions which produced papers stating suggested items for the F.S. and S. of the F. This was then considered by the VCNS as chairman of the Fleet Requirements Committee (of which the Controller was a member) and, if agreed, the paper was passed on for technical consideration by the Controller as chairman of the Ships' Characteristics Committee (of which the VCNS was a member). After a certain amount of Civil Service massaging the plan was then put to the Chiefs of Staff by the First Sea Lord and the inter-service

strangling then got under way. Today what has been described to me as "a far more civilised approach" has been adopted and a series of committees, some inter-service, and numbering up to a dozen or more for a major project, ensure that maximum delays are built-in before the matter receives any form of approval. At a time when technological improvements are advancing at an accelerating rate this frequently means that a proposed ship or its equipment may well be obsolescent before it has been approved.

Three other stoppers are then applied. The machinery of the material divisions of MOD (Navy) at Bath spend a not inconsiderable time discussing all aspects of the ship, (Is it immoral for two Chief Petty Officers to share a cabin? Shouldn't a third be there to ensure a high moral tone?), the Procurement and Contracts people have their say and, finally, if the shipyard workers don't subscribe to Ernie Bevin's cry - "We'll be all right if the buggers work" - then even longer delays result. The final outcome of the whole palaver is that our ships are always late. The average building time for a British frigate is 4 - 5 1/2 years (i.e. completion of the first of a new class can be anything from 10 to 15 years after the first idea was mooted, allowing for a not unusual 5 - 10 years for the Organisation to turn the idea into drawings, an order and construction) while the West Germans produce a similar, if not better, product in 38 months. The first artist's impression of something very like HMS Invincible was produced in 1962 - she will commission in 1980. The Soviet's plans for the 38,000 ton "Kiev" class carriers could not have been tentatively proposed much before 1965 - eleven years later Kiev passed through the Bosphorus. OK, this is a "Moore estimate", but I don't think it's far wrong, and this was the first carrier designed in Russia.

All this comes at a time when the major warships of the Royal Navy have been cut from 172 to 107 with even heavier cuts in minor war vessels and reductions in support ships.

b) Research etc.

For this truncated fleet we appear to have fifteen research establishments for naval purposes, with attachment to about a dozen other inter-service concerns. In some cases industry makes use of service facilities but the prevailing trend is towards the navy acquiring its equipment from such firms as Graseby, Plessey, Marconi, Ferranti, Decca et al. The recent "Stingray" torpedo contract with Marconi is, I believe, unique in its sharing agreements and comes at a time when the Underwater Weapons Establishment at Portland has failed to produce a single operational torpedo design in the last thirty three years. Our nuclear submarines are armed with a mixture of pre-war Mark VIII torpedoes and "Tigerfish", a weapon which industry produced when Portland had failed again. I cannot compute the hundreds of wasted man-hours in my own squadron which were needed to make the "Portland Abortion" (the Mark XXIII) run for selected target trials. Occasionally it burst into flames.

Once upon a time I visited a number of research establishments seeking a particular device - four of them were working on similar lines with no idea of what the others were doing. Would it be too much to expect a central co-ordination with industry?

c) Design

Design depends on role. For many years the Royal Navy had the biggest, bestest ships in the world. Today we can't afford them. We are currently planning a fleet centred on the "Invincible" class small aircraft-carriers which cost about £200 million or more each to carry 18 aircraft. Certainly they have command facilities but, equally, they represent a plum target for any well brought-up submarine CO. To defend them we have the so-called "destroyers" of the "Sheffield" class - cost £30-40 million - and the even larger so-called "frigates" of the "Broadsword" class - cost (at present) £95 million each. A task force of one "Invincible", two "Sheffields" and two "Broadswords" would mean a capital cost of over £450 million. To get a total of 24 aircraft of one kind and another to sea? But that isn't the end. They need an Underway Replenishment Group of tankers and Stores Ships with their own escorts, say another £150 million. I know "things" are expensive these days, but does this make sense? We must pay through the nose for the aircraft but I suggest a study of mercantile designs would produce something efficient and far cheaper in the way of ships. I know that "we must insist on shock-proofing etc" - do we need it if we look realistically at the way the Soviets will fight the war, rather than the way we would fight the war if we were Soviets? We must climb out of "Looking Glass Land" and read what the Soviet instructions say.

And who will design the ships? During the war I used an Admiralty version of the Newfoundland dory for beach surveying. I used it only once because, while the Newfoundlanders produced a craft that two men could run through the surf, the Admiralty effort required six. The current Royal Naval "Amazon" class frigates and the Brazilian "Niteroi" class are highly spoken of in many professional nesses - the comparison with the MOD (Navy) designed "Sheffield" class is unfortunate for the latter. "Amazon" and "Niteroi" were both designed by civilian constructors.

My suggestion is that we are over-staffed in the design establishments at Bath (Foxhill and Enleigh) and that the 4-5,000 drawing office staff now under the wing of British Shipbuilders could produce designs and building drawings with greater speed and equal efficiency to those prevailing under the present system.

d) Weapons Systems

For a number of years we were tied to weapons-systems designed by Admiralty/Ministry establishments. Some relics of these are still at sea. Our sensors were the products of the Admiralty Surface Weapons Establishment at Portsmouth and the Admiralty Underwater Weapons Establishment at Portland. Similarly sized staffs now appear to be needed to monitor the products of our own defence industry. But how good are these products? Is our own defence procurement organisation adequate to monitor modern developments? Why are our new submarines to enter the 21st century with computers that were obsolescent ten years ago? Is this also to be true of our surface ships? Is the water-cooled computer which can be brought to a standstill in a few minutes if its chilled water pipes are cut by shrapnel to be preferred to a fan-cooled computer of a fifth its size? I think it is.

e) Weapons

The British Sea Wolf is probably the best short-range missile system in the world. Good for us. We have a number of other reasonably efficient weapons systems in the anti-aircraft, anti-missile fields. We have adopted French surface-to-surface missiles (Exocet) but why, when converted for Exocet, do our "Leander" class have to lose their main armament guns when the Chilean conversions have kept both guns and missiles and the Dutch have doubled the missile armament and retained a gun armament as well? We have the Australian Ikara anti-submarine weapon but, while they keep their gun-armament when they fit the mounting why do we remove ours?

The "Broadsword" class, larger than earlier light-cruisers, is called a frigate because "it is designed for A/S operations" I was told. It has no close-range anti-submarine/torpedo weapons because they are considered out-of-date. It has sonar, which is being improved, anti-submarine (A/S) torpedoes and two Lynx A/S helicopters (if they really do fit into the hangar). But what torpedoes will they use? Elderly US versions? Or the new British "Stingray" whose batteries and propulsion equipment are possibly suspect? Perhaps the "Heavy-weight" torpedo is to be their main A/S armament but when is this due in service? Will it really operate at maximum speed against the back-pressure at the 3,000 feet of which the Soviet "Alfa" class submarine is capable. And, for that matter, how will it match the performance of the American Mark 48 in its improved version? Are we being a little chauvinistic about this - or is it good for jobs and votes?

f) Propulsion

Are we to live on in the hope that a Micawber-ish turn of fate will provide the energy needed in the 21st century? Maybe the power needed on land will come from nuclear reactors, solar and wind sources, tidal movements and all the rest of the bright ideas which so confused Benn. At sea the only possible power source amongst these is nuclear power with a possible recourse to coal in various forms, if we put enough R and D effort into it, and, as a last resort, wind propulsion.

But over 130 years ago another source of power, the direct conversion of chemical elements to electrical energy was devised by an Englishman. This was the fuel-cell which, perfected by another Englishman, Francis T Bacon, is now used by the USA in its space vehicles and in an underwater craft. Germany, Japan, Sweden and France are diligently pursuing this line and, if the money holds out, West Germany hopes to have an operational fuel-cell submarine at sea in the 1990s. Meanwhile United Technologies in the USA are building a 5 megawatt unit for land use and are considering its application as the power-source for an airship. My most recent discussion on this subject in the MOD finished with the remark, "We can't afford it - let the US do the groundwork and we'll see if it's suitable." We did the groundwork and fifteen years ago Britain had an operational fuel-cell, albeit only a small one, and Francis Bacon is still very much alive. The Ministry of Energy, nudged by Mark Lemnox-Boyd, has given the standard bureaucratic evasions. For a comparatively small outlay, in comparison with our EEC fundings, we could move into a new dimension in co-operation with the USA. But by 1985 we shall lose the rights which are currently shared with that country.

e) Submarines

In 1962 the other Chiefs of Staff put the bite on the 1st Sea Lord and insisted that he agreed to drop future non-nuclear submarine construction if they approved the nuclear submarine programme he was proposing. This was an ignorant and short-sighted proviso but one to which 1 SL was forced to give his agreement. It was ignorant because it failed to appreciate that the UK is surrounded by shallow water (100 fathoms or less) and in such depths a nuclear boat cannot use its full potential, i.e. is not cost-effective. It was short-sighted because it did not take account of the current Soviet order-of-battle, the possibility of escalating costs of nuclear submarines which, even then, were expected to increase dramatically, and tied us to a single method of propulsion.

As a result of this decision the last UK non-nuclear submarine design was made in Bath in the early 1950s, the "Oberon" class. This was an Anglicised version of the American "Tang" class and, despite the then current experience of Bath's submarine designers, had certain inherent faults and dangers. The expert handling and seamanship of those put in charge of these boats has ensured that they have been operated with some success. In the ensuing twenty-five years, while Bath has had no experience of non-nuclear submarine designs, great advances have been made abroad, particularly by the West Germans; these include improvements in battery design, miniaturisation, centralised control and many other aspects. Very simply the Germans have kept abreast of the non-nuclear submarine problem while we have been concerned only with nuclear designs and "very little" of the latter is relevant to the former.

Now that we have appreciated, far too late, that a new non-nuclear class is necessary we have produced a design, the Type 2400. This is not all said with hind-sight - I was present when the 1st Sea Lord was rail-roaded in 1962 and I was nearly slung out of submarines in 1966 when I pleaded with Flag Officer (Submarines) to consider a new design of non-nuclear boat. But in twenty-five years we have fallen behind in the appreciation of non-nuclear design. The Type 2400 is advertised as an "export model" but there are precious few markets available. What appears to have been done is that the hull of the nuclear "Swiftsure" class has been scaled down. A hull which is suitable for the great thrust of nuclear propulsion could be downright dangerous when associated with the reduced power of electric motors. Its ship's company of 46 is considered a revolution - the Germans require about 30 for a similar boat. Its performance on batteries is about half that of a similar German design and it has two less torpedo-tubes. I won't go into further technicalities - from a submariner's point-of-view this Type 2400 is not what the fleet needs, being an out-dated and out-moded design with virtually no export potential. I doubt if even Australia and Canada would be enthusiastic - apart from the design problem they would want some guarantee of the delivery date and I doubt if this would be forthcoming in our present industrial situation.

Alternatives? - the German designs deserve a thorough examination rather than the chauvinistic "not invented here" attitude which is so typical of the Bath approach. Do you remember what Barnes Wallis said? - "I find that there is a natural opposition among all men to anything that they haven't

thought of for themselves." He was speaking of the British aircraft industry - my experience is that this is more than true of the hardware barons of Bath. One day I'll tell you the sad tale of how we failed to have a naval ice-breaker because I was idiot enough to suggest that the Finns designed the best icebreakers in the world.

h) Mine counter-measures

In the early 1960s two matters of importance were evident. Firstly we had successfully produced a mine-hunting sonar set. Secondly the Fleet Requirements Committee agreed that a design should be put in hand for a replacement for the "Ton" class minesweepers which were, even then, still completing. The design of the "Tons" was an early-1950s production and the conversion of each of this class for mine-hunting could cost up to £1 $\frac{1}{2}$ million at 1952 prices. In 1962 a far-sighted Bath designer recommended a glass-reinforced-plastic (GRP) hull. In 1974 Wilton was completed for test and evaluation - a refurbished "Ton" class design in a GRP hull. In 1979 Brecon was completed, a new design in GRP at a cost of about £20 million. Her later sisters may cost no more than £15 million. At the same time we are planning a class of deep-water minesweepers, a conversion of a stern-trawler design, but these would not be available for operations in harbour approaches. There seems no logical reason why terrorists such as the IRA should not be provided with sea-mines by Libya or other paymasters and, when all the "Ton" class have gone in the near future, we may have enough of the costly "Brecons" to keep one port clear at any one time. This would be in so called peace-time - in the event of all out hostilities the situation would be disastrous.

Across the Channel the French, Dutch and Belgians have co-operated in the design of a "Tripartite" minehunter and, between them, are building 40. There is no published price for this class but, as Belgium has ordered ten, I can't believe they are anything like £15 million each. I know we're broke but even a bankrupt must keep his path clear for the groceries. His solution must be ours - the cheapest broom that will do the job.

i) Hovercraft

One way of saving money is to reduce the number of units to do the job and one way of achieving this is to reduce passage time. Brecon can make a transit at 17 knots under reasonable conditions while a hovercraft could probably average 45 knots except in high sea states. The first hovercraft operated in 1959; in 1960-61 certain elements of the Naval Staff pressed for the examination of this machine's capabilities in several roles, particularly minecounter-measures and amphibious warfare. By the mid 1960s the Inter-Service Hovercraft Unit was set up and in 1971 a similar naval unit was commissioned. In 1967-8 a small hovercraft unit of the Royal Marines was operating from Singapore and demonstrated their wares to the Americans in Viet-Nam.

Today the Soviet navy has a rapidly expanding force of hovercraft while we are still evaluating the craft - twenty years after the flight of the first model of a British invention.

7.

j) Amphibious Forces

"There ^{are} no finer amphibious warfare merchants than the Royal Marines" - this was the opinion expressed to me by a US Marine Corps general. "But", he continued, "that is only of value if you can get them to the right place at the right time."

That great expert on amphibious operations, Admiral Gorshkov of the USSR, provided his Naval Infantry with the 4,000 ton "Alligator" class LCT and the smaller "Polnochniy" class. The former has operated worldwide for 15 years. The Royal Marines once had two Commando carriers (Bulwark and Albion) and two Landing Ships (Dock) (LSD) (Fearless and Intrepid). Today they have none of these ships - Albion has gone, Bulwark is a makeshift carrier for another two or three years, one of the LSDs is in reserve and one used for training.

Gorshkov can also call on at least fifteen Roll-on-Roll-off (Ro-Ro) merchant ships with certain naval standards built in and the new 13,000 ton "Ivan Rogov" class LSDs.

The advantage of mercantile design is its cheapness and comparative simplicity to build, as well as reduced complement requirements. The RN has used civilian design in its survey-ships and in Engadine. The latter is manned by a Royal Fleet Auxiliary crew with an RN helicopter detachment on board, her main duty being to provide a deep water helicopter base for ships working up. Application of similar principles of mercantile design and R&F manning with RM or RN detachments on board to provide the fighting capability appears to be a cost-effective means of providing the Ro-Ro and helicopter capabilities the Royal Marines need so desperately.

k) The Off Shore Problem

The acceptance of the 200 mile Exclusive Economic Zone (EEZ) by many countries is causing a notable change in both naval and coastguard forces. It would be boring to go deeply into what the British pompously spoke of as "The Off Shore Tapestry" - I hope that this title has now died. But certain facts stick out like a series of sore thumbs:

- i) The sea-area which now concerns many island and small states is very considerable.
- ii) A number of these islands are relics of the Empire and still Whitehall's responsibility.
- iii) Many of the areas concerned are the responsibility and possible ^{source of} livelihood of small and indigent countries.
- iv) The climatic conditions in which ships and aircraft would operate to carry out surveillance of an EEZ vary enormously - many are in the band of comparatively reasonable weather 2,000 miles either side of the Equator. This means a totally different design of ship for these areas compared with Northern European countries.
- v) In many of our independent Commonwealth countries, e.g. the Caribbean, one of the main problems is control of subversive intruders, gun and drug smugglers.

- vi) New ideas are needed to provide cheap but adequate craft, both sea and air, as well as command and control organisations.
- vii) The growing number of small countries, many of which are of vital importance to us in many ways, need advice and help, both practical and financial. If we fail in this we are leaving them open to leverage from "the other side" and are missing out on a red-hot market in which the French, Germans, Italians, Spaniards and Soviets are already making inroads.

The basic word is "indigent" - poor countries cannot afford expensive vessels and aircraft, cannot afford the training necessary to look after such machines and cannot afford the manpower needed to run them.

1) Exports

The present organisation for market research in the official naval field is totally inadequate and I have yet to find a British ship-builder with a marketing organisation rather than a sales organisation. A measure of this inadequacy is that I have been asked by three major British companies to advise them on possible future markets - and that is ridiculous. British ship-builders are offering three major designs - the Type 24 frigate, the Type 2400 submarine and the Off Shore Patrol Vessel Mark 2 (OPV 2). The Frigate has possibilities, although it may have been pre-empted by French, German and Italian designs. I see no export potential for the submarine and the OPV 2, which will probably cost £8-10 million, is too large, too sophisticated and far too costly for the majority of the likely purchasers.

I'm sorry if this has become a small book - I hadn't intended that when I started. But I feel so very strongly that we have in this country a great potential which is being inhibited by bureaucratic delays, ignorance, incompetence and down-right out-of-date thinking. Our navy could be a far more effective weapon if the excellent people who man it were given ships designed within our budget by an organisation pruned to the needs of that budget and planned to provide the maximum efficiency for stated roles within a clear political directive. It could be done but not by today's methods. Finally, please remember Fink's law - "The problems are increased as the square of those involved."

Thank you, Sam, if you have read this far. I hope you, you and the boys enjoy Christmas and that we may all come safely through the dark tunnel of 1980.

As ever

John

Subject

PRIME MINISTER

MEETING WITH THE CHANCELLOR

I am told that the Chancellor will wish to discuss the following:-

(i) The monetary situation

Money supply figures for December are to be published tomorrow. We were told last week that sterling M3 grew by 0.4 per cent largely because of a big reduction in lending to the private sector. The CGBR remained high. After the heavy gilt sales last week, the Bank are in something of a dilemma. They want to continue the funding programme in order to get M3 firmly within the target range; but the recent heavy sales have put severe pressure on the reserve asset position of the banks - and this is tending to push short-term interest rates up. The Chancellor will, I believe, want to discuss his plans for funding. You might like to ask him about the prospects for getting interest rates down. The latest building society figures suggest that, if interest rates do not fall soon, the rate of mortgage lending will have to fall significantly.

(ii) Public expenditure

The Chancellor will want to report on his bilaterals - in particular, his meeting with Mr. Heseltine today; he may also be able to say how close he is to reaching the £1,000 million target. There is, in addition, the problem of defence expenditure. Mr. Pym's letter in this folder indicates that he is not willing to provide any further savings. Our view is that it would be pointless for Mr. Biffen or the Chancellor to reply to this letter in writing; if the Chancellor is to get anything - he should not give up trying - he should have a meeting with Mr. Pym. (One argument for seeking at least some savings from defence is that we have let defence off lightly on cash limits: we agreed that they should be negotiated with the Treasury in the
/light of

J M

cc Econ PD Pt 3
Domestic Monetary
Policy.

Econ PD Pt 7
Public expenditure

light of further indications of the likely level of defence pay. On the other hand, as I need hardly remind you, Mr. Pym was most reluctant to agree even the compromise formula which was arrived at in November: this was that defence expenditure over the coming years should grow at 3 per cent per annum in cost terms subject to further provision from the contingency reserve for Polaris replacement).

T. G. M. M. M.
f. n. t. l.

16 January 1980

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- 1. Mr. Whitmore
- 2. Pami Minister



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

R

TELEPHONE 01-218 9000
DIRECT DIALING 01-218 2111/3

14/1
cc Econ Pol Pt 7
Public Expenditure

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MO 8/2/12

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11th January 1980

Pami Minister

Dear John,

I mentioned this to you this morning.

Treasury officials have drafted a tough reply, but I have suggested to the Chancellor - and he has agreed - that you and he should discuss this when you meet on Thursday morning and that in the meantime no answer should be sent.

PUBLIC EXPENDITURE

In the light of the Prime Minister's minute of 14th December I have considered very carefully whether I can offer any further reductions in the defence budget.

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I have to tell you that I cannot. The economic objectives towards which the Government is working have always had my complete support, and I fully accept that no programme can claim privileged exemption from the present search for further savings. But the figures to which I am now working are, as you know, very substantially below the bids I considered necessary. The cash limit is really hurting this year - despite the help I was given earlier. For next year I am faced with one which will be very tight and which seems only too likely to exert a further squeeze even on the reduced volume figure I had to accept last autumn. You are already aware of the difficulties of financing the defence programme in the following years. I am striving to eliminate waste. But all the savings I make will be needed to improve the effectiveness of the forces.

/ Indeed ...

The Rt Hon John Biffen MP

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Indeed, I have had to consider, given particularly the recent changes in the world scene, whether to ask for an increase in my planned budget. I have concluded that in the light of the current economic situation it would be wrong for me to do that. But I believe that what we should be considering is whether the Government is doing enough for defence rather than whether we should spend less. I believe that to renege on the 3% increase for 1980/81 or to show a lower rate of increase than we have already agreed upon for the later years would perplex our Allies and supporters, as well as affect the morale of the Armed Forces, in a way which could be seriously damaging to the Government's standing both at home and internationally. The credibility of our commitment to defence is something which we must not put at risk.

I am sending copies of this letter to the Prime Minister, the Chancellor, and Sir Robert Armstrong.

Yours ever

Francis

Francis Pym

CONFIDENTIAL
CONFIDENTIAL

Small red mark or stamp.

Red circular stamp with text: 1980 JAN 14 12:21 PM

14 JAN 1980

CONFIDENTIAL



Defence

*1. Mr Whitmore hml 20/12
v. p.s.*

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Francis Pym MC MP
Secretary of State
Ministry of Defence
Main Building
Whitehall
LONDON SW1A 2HB

R 12/12

19 December 1979

Dear Francis,

DEFENCE CASH LIMITS 1979/80

I was grateful for your letter of 13 December about your cash limits for the current year.

You told me in September that you agreed that the integrity of the limits must be preserved. I am glad now to have your further assurance that you are personally seeing that everything possible is done to ensure that the outturn will be contained within the total of your cash limits. I welcome the action you have taken.

As I am sure you are aware, my officials have warned yours about the extent to which your expenditure has been running ahead of the planned profile, and consequent danger that the cash limits will come under pressure. Their estimate of the potential overspending is still significantly higher than that of the MOD.

You and I are I think agreed that there must not be a repetition in the first year of our Administration of the defence overspending which occurred last year. I am relying on you to take whatever additional measures may be necessary and to bring home to all concerned that the cash limits are an overriding constraint which must be strictly observed, even at the cost of some disruption to programmes.

I am sending a copy of this letter to the Prime Minister.

John Biffen

JOHN BIFFEN

CONFIDENTIAL

20 DEC 1979



PRIME MINISTER

MEETING WITH THE CHANCELLOR: THURSDAY 13 DECEMBER

The following issues are likely to be raised by the Chancellor:

(i) Public Expenditure

There is the note he sent you about defence expenditure (Flag A) on which Robert Armstrong commented at length. You will presumably want to persuade the Chancellor not to make a pitch in Cabinet against the defence spending volume figures. We are likely to have enough trouble getting Mr. Pym to agree the cash limits. There is also a note which came today (Flag B) on the other main options for spending cuts.

*(Robert Armstrong's note on handling of bilateral
or 'star chamber' is at Flag F).*

(ii) Capital Taxation

There is a minute at Flag C in which the Chancellor sets out his provisional proposals - these involve abolishing the investment income surcharge altogether, and significantly reducing the burden of capital gains tax and capital transfer tax. You won't have time to discuss this in detail tomorrow. You might prefer to set up a meeting with one or two other Ministers - for example Mr. Nott and Sir Keith Joseph because of their interest in the industrial implications, and perhaps the Home Secretary to provide a political steer. The main issue will be whether the Chancellor can afford the whole package which will cost about £600 million. In the light of this afternoon's discussion on small firms, it might for example be better to spend rather less on CTT and spend £50 million on the small firms "start up" scheme.

(iii) Treasury Appointments

A meeting has been arranged for Friday morning with Ian Bancroft and others to discuss this, but the Chancellor wants a preliminary word. *(Ian Bancroft's note at Flag E).*

/Following your

*cf Gen Pol (Budget)
Gen Pol (Small firms)
8
Defence*

Following your meetings today about the Local Government Bill, you may want to mention to the Chancellor the capital controls issue. Mr. Heseltine told you that his full package would be saleable, but that the aspects which the local authorities most wanted could not be announced until he and the Treasury (Mr. Lawson) had come to terms over the new arrangements to replace project controls. You told Mr. Heseltine that you would send a message to Mr. Lawson urging the fastest possible progress on this. In practice it might be best to do this by asking the Chancellor to see that work is expedited.

At E this afternoon, it was decided that the Chancellor should look again at the small firms "start up" scheme. But I think there was no suggestion that there should be any announcement before the Budget. I wonder whether the Chancellor should not be pressed to have something ready for an announcement earlier than the Budget. Although implementation would have to await the Finance Bill, this might bring forward decisions by potential investors. And it would be politically helpful. (We did write to the Treasury last month suggesting that an announcement before the Budget would be helpful - see Flag D.)

R.

12 December 1979

CONFIDENTIAL



Defence

Reference: Budget: Pt 1

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

CONFIDENTIAL

MO 8/2/12

13th December 1979

Dear John,

*1. In Whitson ^{tbl} 13 x 12
MOD on over-spending on
cash and under-spending
on volume. Guess why!*

2. P.A.

*R
13/12*

DEFENCE CASH LIMITS 1979/80

When you wrote to me on 19th ^{with request required} October about the overspending on the MOD cash limit for 1978/79, which it is agreed arose for technical reasons, you referred to the signs that expenditure in the current year appeared to be running higher than planned levels and the importance which we both attach to restraining expenditure within the cash limit.

We have been monitoring the position closely and I am being kept closely in touch with what is happening. As forecasts still indicate the possibility of an overspend of about £80M a number of steps to restrict expenditure are being put into effect. First, a number of specific economy measures amounting to £25M will be taken and an examination has been put in hand to identify further measures which might be taken early in January, should the forecasts then show this to be necessary. Second, general instructions are being issued by the Accounting Officer and the Chiefs of Staff that expenditure on activities such as travel, training and overtime must be cut back as far as is possible without interfering with operational capability. Third, no new commitment involving expenditure this year will go ahead except for operational reasons. I understand that my officials have explained the position to yours.

I can therefore assure you that I am personally seeing that everything possible is done to ensure that outturn will be contained within the cash limit.

I am sending a copy of this to the Prime Minister.

James
Francis Pym

The Rt Hon John Biffen MP

CONFIDENTIAL

13 DEC 1979



Ref: A0924

SECRET AND PERSONAL

MR. LANKESTER

1. An Whitman JMW
2. J.

Prime Minister Defence
I think you should
dismiss this with the Chancellor
before Cabinet on Thursday.
But you might also discuss
with Robert Armstrong after
E tomorrow (see last para).

attached 1

You asked for advice for the Prime Minister on the Chancellor of the Exchequer's Secret and Personal minute of 11th December about defence expenditure.

R
1/12

2. The first thing to be said is that the problem is even more difficult than the Chancellor has indicated. His proposals on cash limits for 1980-81 are based on a pay and price increase of 14 per cent. On present prospects the eventual increase in pay and prices seem likely to be higher than that. The defence budget is peculiarly vulnerable on this account. Armed Forces pay is determined by the recommendations of a Review Body; the recommendations of that Body, due to come into effect on 1st April 1980, are unlikely to be below the "going rate", which might well be $17\frac{1}{2}$ per cent or more, and it will be very difficult for the Government, in view of its previous commitments not to accept whatever is recommended. On the equipment side, defence expenditure is vulnerable to a "sophistication factor" which generally has the effect that price increases are larger than average in that sector. On the basis of reasonably realistic assumptions about these two factors, the Chancellor's proposals on cash limits imply a volume squeeze on defence expenditure in 1980-81 of the order of £150 million.

3. If this is allowed for, the reductions proposed in paragraph 3(a) of the Chancellor's minute - the ones he himself prefers - imply a spend of about £7,675 million in 1980-81, and correspondingly reduced figures for later years; this figure compares with the figure of £8,062 million published in October's White Paper - a reduction of about £400 million or 5 per cent.

4. Even the less drastic reductions in paragraph 3(b) of the Chancellor's paper would be increased, for 1980-81, from about £100 million to about £250 million.

5. There is also the problem of Polaris replacement. This was more or less allowed for in the understanding arrived at earlier - though even then you did not preclude the possibility that some of the cost of the Polaris replacement programme might be found from within the existing levels of the defence budget.

SECRET AND PERSONAL

The run of figures resulting from the understanding is that at the bottom of the first page of the Chancellor's minute. These are the figures for which the Secretary of State for Defence believes he has agreement; and the Chancellor is, in practice, talking about reductions of somewhere between £250 million and £400 million on these figures, when one takes account of the volume squeeze resulting from his proposals on cash limits.

6. Past experience suggests that the Secretary of State for Defence will not readily accept reductions on this scale. On the other hand the Chancellor is pushing his luck in canvassing the possibility of reductions in the defence budget as part of the new review: the figures which he circulated for the Prime Minister's meeting on 7th December suggested ways in which £1 billion could be saved in 1980-81 without any reduction in the defence budget. He would be asking a lot if he went for reductions in the defence budget on top of the volume squeeze implied by his proposals on cash limits.

7. The immediate question is how to handle this problem ahead of Cabinet on Thursday. There does not seem to be any possibility of the Prime Minister holding a meeting with the Chancellor and the Secretary of State for Defence before then, because the Secretary of State for Defence will be in Brussels until late tomorrow evening, and the Prime Minister has to go and wave goodbye to President Tolbert before Cabinet on Thursday morning. In any case, I do not think the Prime Minister ought to involve herself in this with the two Ministers together at this stage. If that is right, we have to find some way of getting through Cabinet on Thursday so that the two Ministers can discuss the problem thereafter, as part of the public expenditure bilaterals which should follow the Cabinet meeting.

8. It may be that the Prime Minister will think that, as the Chancellor was able to produce a package of £1 billion in 1980-81 without including reductions in the defence budget, the right course would be for her to tell him to stick to that, and not to risk a major confrontation with the Secretary of State for Defence by trying to get even more out of the defence budget than is implied by his proposals on cash limits.

SECRET AND PERSONAL

9. If, on the other hand, the Prime Minister agrees with the Chancellor that the defence budget will have to contribute to the £1 billion, I think that she ought herself to have a word with the Secretary of State for Defence, without the Chancellor of the Exchequer, to try and soften him up and, at the very least, of making some judgment of what his reaction is likely to be.

10. However that is to be handled, there remains the problem of getting through Cabinet on Thursday. On present plans, the Chancellor is expected to talk about the total reduction to be sought, but not to give any indication of the way in which he thinks that that total should be made up. In discussion, however, it is almost bound to emerge that he is looking primarily at the social security programme and at housing. There is obviously a considerable likelihood that some Minister or other will suggest that the defence budget should not be excluded from scrutiny. If that happens, the Prime Minister will have, I think, to say that these are all matters to be pursued by the Chancellor of the Exchequer and the Chief Secretary in their bilaterals, and the Cabinet is not asked to and should not take any decision or express any views at this stage.

11. If the Prime Minister is minded to deal with it in this sort of way, she ought, I think, to send the Chancellor of the Exchequer a personal note, or have a word with him, to make sure that he plays it that way and does not rock the boat at the meeting of the Cabinet. I understand that she will have an opportunity to do that early on Thursday morning, when she is due to meet the Chancellor. If, when she has considered the Chancellor's minute and decided what line to take, she would like to have a draft minute or Speaking Note for her meeting with the Chancellor, no doubt you will let me know.

12. We are still left with the problem of the volume squeeze on the defence programme implied by the Chancellor's cash limit proposals. The Secretary of State for Defence can, on past form, be expected to react very strongly against these and their effects on his budget. He will say that the Chancellor is trying to get by the back door reductions in the defence programme which he failed to get at the earlier stage, and he may say that what the Chancellor proposes is not possible for him to tolerate. There are various possibilities of

SECRET AND PERSONAL

mitigating the Chancellor's proposals on the defence budget. One could take the pay of the Armed Forces out into a separate block for cash limit purposes, and deal with that as it is proposed to deal with Civil Service pay, by fixing the cash limit at a later date when the probable outcome of the Review Body's latest inquiry is clearer and it is possible to arrive at a realistic cash limit for Armed Forces pay. But the Prime Minister should be advised, and I should be happy to discuss with her, what steps if any we should take before Cabinet on Thursday, to try to defuse the Secretary of State for Defence's adverse reaction, which could otherwise become the spark which led the Cabinet to reject the Chancellor's proposals as a whole.

RA

PR

(Robert Armstrong)

11th December 1979

6A



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

DEFENCE EXPENDITURE

Arithmetically and politically, it will be hard to achieve the required level of public expenditure cuts if the Defence Programme - one sixth of total central government expenditure - remains exempt. The CPRS are right to suggest that Cabinet will wish to review the exemption, but they are, of course, unaware of the delicacy of any review given the position which Francis Pym adopted in the aftermath of the October discussions. We cannot duck the issue, but in view of its sensitivity, I think it right to consult you before tabling any proposals.

2. The figures which I proposed, and Cabinet accepted, in October:-

<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
8062	8250	8450	8650

were framed to meet the NATO target in cost terms in each year, and to provide for an average 3 per cent increase in volume terms over the five years from 1978/79. The subsequent private understanding with Francis Pym could raise these figures to:-

<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
8062	8304	8553	8810

i.e. the straight 3 per cent volume progression to which he attached so much importance.

13. In considering



3. In considering what reduction in these figures we could sensibly make, I have identified two courses:-

(a) We could make use of the provision for derogations in the case of economic difficulties which is written into the NATO target. The deteriorating economic forecasts, and the problem of our Community contributions - which is exacerbated by the rising cost of BAOR - would be sufficient reason for imposing a moratorium on increases in Defence spending in 1980/81: for that year we should keep for volume planning purposes the same figure as in the October ^{White} ~~written~~ paper (Cmnd 7746) for 1979-80. I believe that our position would be understood, especially if we reverted to the 3 per cent volume progression after 1980-81. The figures would then be:-

<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
7824	8062	8304	8553

(b) Alternatively, we could maintain a 3 per cent volume progression, but build it on the lower base-line provided by the Ministry of Defence's latest forecast of their expenditure this year in volume terms, which is some £100 million less than the figure tabled in the October discussions, and published in Cmnd 7746. The progression would then be:-

<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
7966	8205	8451	8705

4. Obviously, I prefer course (a). Compared to the figures which Cabinet agreed in October, as modified by the subsequent understanding with Francis Pym (the second line of figures in paragraph 2 above), it would yield savings of:-

238	242	249	257
whereas course (b) would produce only:-			
96	99	102	105



5. OD recognised on 3rd December that we must cut our defence coat according to the cloth we can afford. With Defence's share of GNP growing rapidly, we shall have to fall below the NATO target at some stage. There is much to be said for doing the job quickly and cleanly, and confining it to one year. We would not be alone: the Germans, for example, have failed to provide for a 3 per cent increase in 1980.

6. But course (a) would be much more difficult for Francis Pym, I would not press for it if you thought that the savings under (b) would constitute a sufficient contribution from defence to the present cuts exercise, and that Cabinet would agree. Not knowing of the subsequent understanding with Francis Pym, most of our colleagues would recognise only the much smaller savings against the October figures (£96m in 1980-81, and £45m in 1981-82, offset by a £55m increase in 1983-84).

7. Any cuts in defence involve re-opening the private understanding. Either of the courses proposed would eliminate the need for separate provision from 1981-82 for Polaris replacement costs to maintain 3 per cent annual volume growth in those years.

8. I think we have to grasp this nettle. I understand that Francis Pym is to attend the NATO meetings in Brussels in the early part of the week, which may make it difficult to arrange before Cabinet on 13th December, but I suggest that the best way to take things forward would be for you to take a meeting of Francis Pym, John Biffen and me. In preparation I could send him a note on the lines of this minute setting out the alternatives as I see them, but I should first like to know your views, both as to substance and as to procedure.

A handwritten signature in blue ink, appearing to be 'G.H.'.

(G.H.)

11 December 1979



TMP/JS
cc CO
17MT 6
Defence

10 DOWNING STREET

From the Principal Private Secretary

6 November 1979

Dear Tony,

DEFENCE EXPENDITURE 1981-82 to 1983-84

When the Prime Minister met the Chancellor of the Exchequer, the Secretary of State for Defence and the Chief Secretary at 2215 yesterday evening in her room at the House to discuss the Chancellor of the Exchequer's minute of 30 October about defence expenditure, the Chancellor of the Exchequer said that it had been only with the utmost reluctance that he had accepted the position set out in the note attached to his minute and he remained anxious about its implications. If the sentence in paragraph 5 of his note was incorporated in the Public Expenditure White Paper, it was bound to provoke comment in Cabinet when they considered the draft White Paper just before Christmas. By that time decisions on the replacement of Polaris might or might not have been taken but whether they had or not, he thought that the reply to any questions by Cabinet colleagues might follow the lines set out in paragraph 4(c) of his note. He thought it not unlikely that some members of the Cabinet would want to probe what was said in the White Paper. There was also bound to be comment on the sentence when the White Paper was eventually published. Looking further ahead, he hoped that the Defence Secretary understood that the economic battle over the forthcoming year was going to be extraordinarily difficult, and that, as part of the battle, it would continue to be essential to reduce public expenditure. It had to be understood that the formula which he proposed in paragraph 5 did not mean that the whole cost of the Polaris replacement programme would necessarily be found outside whatever levels Ministers otherwise approved for the defence budget.

The Chief Secretary said that the sentence in the White Paper was almost certain to cause other Cabinet Ministers to ask whether their programmes would be affected by the need to finance the Polaris replacement programme. He thought that some Ministers would want to take a hard look at the proposal to replace Polaris before the Government entered into any commitment. He believed himself that if developments in the economy necessitated further domestic retrenchment, the Polaris replacement programme would not be above re-examination.

/The Secretary of

SECRET AND PERSONAL

- 2 -

The Secretary of State for Defence said that he was ready to go along with the proposal in the Chancellor of the Exchequer's note. He accepted that what should be done about the cost of the successor to Polaris after the present PESC period was for subsequent consideration. How the programme should be financed was a question of the nation's priorities.

The Prime Minister said that she thought they could rest on the sentence in paragraph 5 of the Chancellor's note. This did not preclude the possibility that some of the cost of the Polaris replacement programme might be found from within existing levels of the defence budget. It safeguarded the positions of both the Chancellor of the Exchequer and the Secretary of State for Defence. The Defence Secretary had accepted that provision for the defence programme would in any case have to be reconsidered, like that for all other programmes, in a year's time in PESC 80. What levels of defence expenditure the Cabinet would agree upon would depend on the circumstances at the time. By then the decision on the replacement of Polaris would have been taken and to that extent the demands on the defence budget would be clearer than they were now. For present purposes the figures for the defence budget should remain as in the Chief Secretary's paper C(79)35 and the Public Expenditure White Paper should contain the sentence in paragraph 5 of the note by the Chancellor of the Exchequer. There was no need to raise the matter again in Cabinet before they considered the draft White Paper shortly before Christmas.

I am sending copies of this letter to Brian Norbury (Ministry of Defence) and Alistair Pirie (H.M. Treasury).

Yours ever,

John Whitman.

A.M.W. Battishill, Esq.,
H.M. Treasury.

SECRET AND PERSONAL

Mr Lancaster ←

Defence

Top Copy on: Civil Service,
P2, c.c. Mr. Wolfson
Manspinner Mr. Whitmore
Emergency.

PRIME MINISTER

Meeting with the Chancellor at 0930 on Thursday, 1 November

I don't know of anything in particular which the Chancellor wishes to raise with you tomorrow morning. He was to have discussed the Bray forecast (i.e., the forecast of the balance of payments, RPI, etc., which has to be published before the end of November), but the Chancellor is not yet ready with firm proposals - he will be minuting you over the weekend.

30.10.79 The Chancellor may want to have your reaction to his minute on defence expenditure, which Clive took to Bonn. I think the only issue now is how and when to reveal the deal which has been agreed between Treasury Ministers and Mr. Pym to Cabinet colleagues. But you don't need to decide this immediately.

You might just take the opportunity of discussing the papers for Cabinet. On vehicle excise duty, you might query the Chancellor's reasons for wanting VED to continue: my own feeling is that he exaggerates the advantages of so-called "fiscal flexibility". Of course, we need the money; but the unpopularity of raising petrol duty would be matched - in my view - by the popularity of abolishing VED. And of course, abolition would give us substantial staff savings, as well as being good for energy conservation.

Lord Soames' paper on "Further Action to Reduce the Size of the Civil Service" is difficult. I have provisionally asked Lord Soames to join you and the Chancellor at 0945 to discuss it.

Lord Soames' paper offers three choices for decision. Cabinet are likely to go for either.

(i) Announce savings of 6% plus vague promises of more to come.

Or

(iii) Announce savings of 6% as an interim measure with firm promises of more to come next Spring.

/ Option (i)

Option (i) is the more likely outcome I think, since (iii) presupposes the outcome of the MOD manpower studies and certain policy decisions (listed in Annex 4). If (i), there is the question of whether the present exercise which has been carried out separately from the public expenditure exercise should be carried forward as part and parcel of next year's public expenditure exercise.

There may have been advantage in looking at Civil Service staff as a separate exercise this year when the Government knew there was staff "fat" in programmes, and when a reduction in Civil Service staff was being sought - to some extent - for its own sake. But as soon as functions and policies have been looked at as a way of finding savings, there has been an untidy overlap with the public expenditure review. Taking into account the fact that CSD have not carried out the present exercise very well, there may well be a case for making the search for further staff savings under the umbrella of next year's expenditure review - with the Treasury taking overall responsibility. Under this formula, the CSD would assist the Treasury in identifying public expenditure savings (including staff cuts), rather than offer their own options. This is the way PESC should have been conducted in the past. In practice, CSD have contributed very little to previous PESCOs - which is one reason why we set up this year's quite separate exercise. What I am suggesting is an improved PESC next year with staff options being given greater attention than they have been in the past.

You don't need to reach a firm view on this question now, but you might like to mention it to the Chancellor and the Lord President as something which needs to be considered. We could ask that this question be covered in the review of PESC methods which Sir Robert Armstrong and the Treasury have set in hand. (There is of course also the wider question of the future of the Treasury and the CSD. There are some - including John Hunt - who think the public expenditure control function of the Treasury should be taken out of the Treasury and integrated with the staff

control function of the CSD to form a new "Department of Public Expenditure". Others think that the CSD should go back to the Treasury. In both cases, the present illogical division of control over expenditure programmes from control over staff - which are the main cost element in many programmes - would be ended.)

72

31 October, 1979.

Prime Minister. 5



This gives Mr Pye virtually the original option 5.
Are you ready to have the meeting the Chancellor proposes at XI
John?

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Attil
30x.

Yes and

PRIME MINISTER

DEFENCE EXPENDITURE 1981-82 to 1983-84

See Pub. Expⁿ
p. 5, Econ. Pol.

As you know the Chief Secretary and I have been considering what can be done, without re-opening now the Cabinet's conclusion of 18th October, to meet the Defence Secretary's difficulties on the figures which Cabinet then endorsed for defence expenditure in the years 1981-82 to 1983-84.

...

2. The attached note sets out a proposal which the Defence Secretary has indicated he would accept with reluctance. The Chief Secretary and I would also be prepared to go along with it in substance, but before we reach a conclusion in this sense, I must emphasise to you my anxieties about it, not only as to the position of Treasury Ministers in regard to expenditure control but as to the reactions of the Cabinet generally.

3. This arrangement is designed to avoid having to re-open the Cabinet decision now. But it will have to become known to Cabinet at some point. It will then be evident that the Prime Minister, Treasury Ministers and the Defence Secretary have arranged, behind the back of Cabinet as a whole, some sort of deal which goes against the majority opinion in Cabinet as expressed on 18th October and which gives preferential treatment to the Defence Secretary compared with that of other spending Ministers whose plans were determined multilaterally, in some cases contrary to the preferences of the Minister concerned.

/4. The problem



4. The problem is highlighted by paragraph 5 of the note and the suggested sentence for the White Paper. This sentence is true, and the Defence Secretary feels that he must have it in the White Paper in order to avoid the presentational problems which throughout have exercised him if the White Paper comes out with the figures as they now stand. But the inclusion of the sentence will bring the matter out at Cabinet when they are asked to clear the text of the White Paper, which on present plans would be on 20th December. It will invite attention then to the whole question of the deterrent, which you may not then be ready to discuss in full Cabinet. The reference will also excite public interest in the point when the White Paper is published, ^{and} possibly provoke criticism of the defence figures on the ground that they omit the most important element.

5. Even if this sentence were not in the White Paper, and the Defence Secretary insists it should be, the problem would remain when the figures were published, since the Defence Secretary would want himself to say what the sentence says, if only to justify the programme to his NATO colleagues and to the defence interests in the Party. And the arrangement will need to become known within the Ministry of Defence.

X | 6. I urge that you hold a meeting with the Defence Secretary and John Biffen and myself to go over this ground. If we are to go down this road, we must do so in full understanding of all the implications which affect us all.

7. I am sending a copy of this minute to the Defence Secretary and to John Biffen.

A handwritten signature in dark ink, appearing to be 'G.H.'.

(G.H.)
30th October, 1979

DEFENCE EXPENDITURE 1981-82, 1982-83, 1983-84

1. The Proposed Solution

It is agreed that :

a) The defence figures remain as in the Chief Secretary's paper which Cabinet endorsed) C(79)35 for this year's public expenditure White Paper to be published in January.

b) If the Government decides to replace the strategic nuclear deterrent - no firm or formal decision has yet been taken - the extra costs arising in the three years 1981-82 to 1983-84 will be met from the Contingency Reserve, increasing the C(79)35 figures for the defence programme, up to amounts not exceeding what will bring the annual increases of defence expenditure in those years up to 3% each year in volume terms.

c) These additions are conditional on the absorption, within the revised defence figures, of

- i) the running costs of an expanded Hydrographic Fleet (whether arising from chartering or building ships) to meet urgent civil hydrographic survey requirements (estimated at £5m p.a.);
- ii) an agreed share of the capital costs of 4 new inshore fishery protection vessels (some £17m over 5 years);

and on the MOD continuing actively to pursue measures to ensure maximum cost effectiveness and efficiency in the defence programme and the elimination of waste.

2. In the next year's Public Expenditure Survey, or if plans for replacing the nuclear deterrent are still uncertain then, in some future year, the required provision (within the 3% annual volume growth limit) will be added to the defence programme figures which, other things being equal, would thus be increased. (Formally, the Contingency Reserve would be written down by equivalent reductions; but the amount of the Reserve is liable to adjustment anyway each year, whereas the defence programme normally is not).

Consequential announcements

3. The public expenditure White Paper will probably be published in mid-January. A formal decision concerning the replacement of the nuclear deterrent may be taken shortly before that. It may or may not be announced immediately.

4. In Cabinet

a) As no formal decision has yet been taken on whether, when and in what form to replace the nuclear deterrent, the defence figures will not be changed until that decision is taken; so Cabinet need not and would not be informed about the proposal now.

b) When the decision to replace the deterrent is taken, the Prime Minister will need to consult or inform Cabinet about that decision and its public expenditure implications, saying in substance: "The bulk of the expenditure will fall after the present Survey period. But some will fall within it. It was not practicable to take this into account during the recent Survey and no specific provision was made in the agreed programme. So far as is practicable it ought to be absorbed within the defence provision already agreed, but, in view of the overriding national importance of the work, the Chancellor and the Chief Secretary have agreed that additional expenditure (at 1979 Survey prices) of up to £50m in 1981-82, £100m in 1982-83 and £160m in 1983-84 should constitute a call on the Contingency Reserve for the years in question".

c) Whether or not the replacement decision has been brought to Cabinet by then, if the words suggested in para 5 below are included in the White Paper, they would be seen by Cabinet when the draft White Paper is taken, probably on 20 December. If this prompts questioning, the reply would be: "No formal decision has yet been made, so no specific provision has in fact been made in the figures. If replacement is decided upon, there will need to be a claim on the Contingency Reserve, which the Chancellor and the Chief Secretary accept".

In the White Paper

5. It is unlikely that the replacement decision will be taken and announced in time for reference to it in the White Paper. The following sentence would be included in the White Paper: "These figures do not include specific provision within this Survey period for the replacement of Polaris, on which no decision has yet been taken".

In Parliament

6. A reference to the use of the Contingency Reserve would be included in a Parliamentary announcement of the replacement decision, if and when that announcement is made.

In NATO

7. At the NATO meeting in December, the Defence Secretary would say "We have met the NATO target for an increase in defence expenditure of 3% in real terms in 1980-81. I can reaffirm our firm intention to meet the target in later years".

8. If the replacement decision has not been announced by the time that the White Paper is published the Defence Secretary would make use of the sentence in paragraph 5 in dealing with any NATO questions.

30 OCTOBER 1979

PRIME MINISTER

Defence

MEETING WITH THE CHANCELLOR - THURSDAY 25 OCTOBER

The Chancellor wants to discuss four points with you tomorrow:

- i. The defence expenditure problem. His minute attached proposes a way through - not likely, in Clive's and my view, to satisfy Mr. Pym.
- ii. An appointment to the court of the Bank of England (I don't know the name he has in mind).
- iii. Rhodesia - the implications for the Treasury of certain outcomes (possible threats to investments in the rest of Africa, possible expenditure for compensation of white Rhodesians, etc).
- iv. EEC Budget. I understand the Chancellor wants to re-open this morning's discussion on the possibility of unilaterally putting a ceiling on our contribution.

If there is time, you may want to discuss the handling of the public expenditure papers in Cabinet. The RSG paper is the most difficult. It seems to me that you should go for a 60½ percentage RSG (anything lower will swing the RSG away from the shires and will in any case be hard to get through Cabinet), and the lowest inflation assumption - i.e. 13 per cent.

12.

24 October 1979

Prime Minister.

4



If it was as difficult as we believe to sell option 5 to Mr Pym, I doubt whether he will accept the Chancellor's compromise (paragraph 3).

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

In any case the Chancellor's compromise breaches his principle of going above the figures agreed by Cabinet and of not raiding the Contingency Reserve. But if he is ready to do that to the tune of £55 million, what basic agreement can he have to going up to £160 million and giving Mr Pym what he wants - bearing in mind the political dangers of not doing so?

PRIME MINISTER

DEFENCE EXPENDITURE

A.H.H.

24x.

In an effort to resolve the dispute with the Defence Secretary over defence figures for the later years, John Biffen and I have been considering possible modification to the proposals in C(79)35.

2. We should much prefer to stick to the figures which the majority of our Cabinet colleagues approved. They show a 3 per cent a year increase in cost terms over the last three years, add £700 million to the previous Government's plans, raise the Defence share of GDP from 4.9 per cent to over 5.5 per cent, and of total public expenditure from 11 per cent to 13 per cent. Furthermore, they also show an average increase of 3 per cent a year in volume terms over the whole of the 5 year period to 1983/84. If it would help, we should be ready to forego public presentation of these figures in cost terms, and to rely on the average annual 3 per cent volume increase. This would effectively accept the Defence Secretary's main premise that we should plan to meet the NATO target in volume not cost terms. It would also be consistent with your own support for the NATO target in your Luxembourg speech last week.

3. If nevertheless you felt that this would be insufficient to meet the Defence Secretary's demands, and would wish to



make a new financial concession to him if Cabinet colleagues agreed, then we have found a new formula for calculating his "entitlement" which would make it possible to make the proposition more attractive by offering some more money. Our original figures were based on an earlier forecast of the expected outturn for 1978/79. The latest provisional outturn is a little higher. We ought in logic to reduce that figure by the amount of the overspend which occurred. But by working from the adjusted figure to be published next week, and adding increases of 3 per cent a year compound over the five year period, it would be possible to raise the figure for 1983/84 from our proposal of £8,650 million by £55 million to £8,705 million. The figures for the previous two years could also be slightly raised. For convenience, I attach a table showing the various runs of figures and the percentage increases they would allow.

by £21M and
£35M

4. This option has the disadvantage (inescapable, if we are to go down this road at all) that it would increase the public expenditure totals. Nevertheless, it has certain real advantages. It would provide a firm run of figures. It would also mean that our acceptance of the NATO target in volume terms was on the basis of an annual average of 3 per cent rather than a year on year increase of 3 per cent, which could prove to be a costly commitment if projected into the future.

5. The third option, to which we see very serious objections, would be to publish the figures we proposed in C(79)35, but to allow limited increases in these figures at the expense of the contingency reserve, to provide for the cost of Polaris replacement. It would be essential to avoid an open ended commitment, and these increases should therefore not exceed the sums necessary to bring the growth rate for the years 1981/82 to 1983/84 up to 3 per cent a year in volume terms. This is not however a course which we could recommend. It



prejudices the normal principle that weapon system replacements are met within defence budget ceilings by dropping items of lesser priority - a discipline essential to the achievement of cost effectiveness. It would reduce the contingency reserve, and thus pre-empt for defence a growing share of resources which would otherwise be available to other programmes for their unforeseen and priority needs. But perhaps the main problem is that of presentation - how to explain to our Cabinet colleagues the reasons why we were giving defence more, effectively at their expense, and how to present the position publicly when the White Paper is published next January. In practice, the proposition (if it is not to be entirely open-ended - which is surely unacceptable) amounts to much the same thing in money terms as agreeing to the Defence Secretary's bid for 3 per cent volume increases in the last three years. It might be less damaging - though still difficult to explain to our colleagues - simply to agree to the latter.

Indeed. That is the point of his option.

6. None of these options is palatable. The third is not one which either of us feels disposed to accept. But if the first is regarded as un-negotiable, we should be prepared to live with the second. If you agree, you may wish to try it on the Defence Secretary yourself. As you will realise, any concession to him represents a serious erosion of our position. It is obviously all the more important that we should have the wholehearted support of all our colleagues on the public expenditure issues still outstanding.

G.H.

(G.H.)

24 October 1979

£m at 1979 Survey Prices

	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	Average % increase over 5 years
C(79)35 figures	7479	7824	8062	8250	8450	8650	
% increase (volume)	4.6	3.0	2.3	2.4	2.4	2.4	3.0
% increase (cost terms)	8.8	3.0	3.0	3.0	3.0	3.0	4.1
Defence Secretary's proposal	7479	7824	8062	8304	8553	8810	
% increases (volume)	4.6	3.0	3.0	3.0	3.0	3.0	3.3
Second option (partial concession to Mr. Pym)	7509	7824	8062	8271	8485	8705	
% increases (volume)	4.2	3.0	2.6	2.6	2.6	2.6	3.0

SECRET

3B

PRIME MINISTER

Defence Budget

Sir John Hunt has reported that Mr. Pym has now gone along with Option 5 on the Defence Budget, ie we publish the "Biffen" figures; explain that they are less than 3% by volume but make clear that they contain no provision for the replacement of the deterrent which will be financed by additional provision from the contingency reserve. He has also accepted that the question of manpower cuts in the MOD should be separated from the problem of the Defence Budget and should be dealt with later. I understand that getting Mr. Pym's agreement to go along with this package was more difficult than had been expected.

Sir John Hunt has also told me that Sir Douglas Wass has briefed the Chancellor of the Exchequer against Option 5. He is still of the view that the cost of the replacement of Polaris should be contained within the "Biffen" figures at the expense of provision for conventional forces.

Now that Mr. Pym is on board, however reluctantly, the way is clear for you to see the Chancellor to get him to go along with Option 5. There would be advantage in getting this sewn up quickly (though not reporting the outcome to Cabinet until its meeting on 1 November). May I now arrange a meeting with the Chancellor as soon as possible?

Yes
aw.

AW.

Prime Minister.

22 October 1979

I mentioned this to you this afternoon and you agreed to see the Chancellor as soon as possible. We have in fact arranged this for 0845 tomorrow Tuesday. The other papers are below.

SECRET

AW

22x.

Prime Minister.

Ref: A0464

HW
19x.

SECRET

PRIME MINISTER

Defence Budget

Following my conversation with you on the telephone at Northolt yesterday, I can now report that the position has been held at least for the next few days and that I can see the possibility of a solution.

2. Before coming to that I would like to deal with the question of the Cabinet minutes. I have withheld the minutes on this item today (this is easily done, since it will go as a 'Limited Circulation Annex') and I attach the draft which I have in mind to circulate. As you will see the section on defence neither records a final decision nor specifically leaves the matter open. It talks about a majority view. This may be helpful in considering the tactics which I outline below and avoids pushing Mr. Pym into a corner at this stage. Are you content that the minute should go round in this form?

3. Next I think I should spell out what I understand to be Mr. Pym's attitude. This is based both on a conversation I have had with him myself and on three talks with his Permanent Secretary (Sir Frank Cooper) with whom he has been in close conclave.

Alton

4. Mr. Pym has three main objections to the Treasury line as it was put at Cabinet. First, he believes he is already publicly committed, with your support (Mr. ^{Cooney's} Lankester's letter of 14th May) to the 3 per cent target in the sense in which he interprets it. Second, he objects strongly to what he describes as the 'jiggery pokery' involved in the kind of presentation suggested by the Chief Secretary. Third, he refuses to mislead either the Alliance or the Party (in this connection it is relevant that Dr. Aaron brought a message this week on the crucial importance which the Americans attach to our achieving the 3 per cent if the other allies are to be kept up to the mark). I suspect that underlying his objections of principle there may be another concern: it has always been clear in MISC 7 that there is no replacement for the deterrent in the Defence Budget at present, and the figures suggested by

SECRET

the Chief Secretary will leave no room for this. By pure coincidence it so happens that the cost, towards the end of the period, of the replacement deterrent would be roughly the same as the difference between the Chief Secretary's and the Secretary of State for Defence's figures!

This refers to the cost of the PESC period.

5. Mr. Pym is also very concerned about the question of staff cuts, which Cabinet is due to consider on 1st November. The Chiefs of Staff are almost more worried about Lord Soames' likely proposals than they are about the disagreement with the Treasury over the 3 per cent arithmetic. They were on the point of exercising their right to ask to see you last week, but he has successfully held them off for the time being. If Cabinet insisted both on the expenditure cuts and on the staff cuts i.e. a double blow, you might well be faced with a threat of resignation by the Chiefs and the Secretary of State for Defence's position would be even more difficult. Any solution will have to take account of this point. I return to this below.

See Lord Soames' minute of 19 October to you in the red box.

6. Whatever the main reason underlying Mr. Pym's attitude I am clear that, while he will do nothing in a hurry, he will not in his present frame of mind accept yesterday's Cabinet decision. Following a private talk with the Permanent Secretaries concerned, I have prepared a list of the possible options. We all think that the options at the extremes of this list will be unacceptable either to Mr. Pym or to the Treasury. I think Option 5 has some chance of being accepted by Mr. Pym: and Sir Frank Cooper agrees. Whether the Chancellor would accept it is another matter: Treasury officials would like to squeeze our conventional forces to make room for the deterrent but this seems to me quite unrealistic. The essence of this option would be that the White Paper would contain the Chief Secretary's figures but not his rationalisation of them. It would go on to say that while the figures provided for a volume increase in defence spending over the period a little below the NATO target, they contained no provision for replacing the deterrent which would fall to be decided in the period - and provision for which would be made from the contingency reserve [It might also be possible to use the

attached below

SECRET

occasion to pave the way for a change in the presentation of our figures on to the cost basis favoured by the Chief Secretary. All of this would require careful, but not impossible, drafting.

7. If a solution on these lines is not possible the only course I can see which will avert the situation we feared is some way of "fuzzing" the later years: but this would be much less satisfactory.

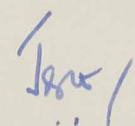
8. This arrangement would not however resolve the manpower issue, which it would be prudent to settle at the same time. Defence might be able to offer a saving of another 15,000 staff, including the 3 per cent cuts they have already imposed. You have however had a minute from Lord Soames today making it clear that he wants to go for a full 10 per cent cut on the Ministry of Defence. Unless both Mr. Pym and the Chiefs of Staff can be overruled on this, Lord Soames will have to be persuaded to drop his bid, perhaps on the argument that the separate in-house studies being undertaken by the Ministry of Defence would produce further savings in due course. But this would leave the Cabinet very well short of the 10 per cent overall target which was tentatively agreed in September, and there may well be problems in other areas (the Revenue Departments and DHSS) as well. I understand that the CSD view is that we shall be lucky to get cuts of 5 - 6 per cent overall.

9. If you think a solution on these lines is appropriate, I believe you should avoid an early meeting with the Secretary of State for Defence; (and I understand that he is not seeking an early one with you). You should first see whether Option 5, or something like it, would be acceptable to the Secretary of State for Defence and to the Chancellor. The Home Secretary might be a suitable intermediary for this purpose. If it can, then Lord Soames will also have to be brought to agree. There is then a separate problem of presenting the agreement to the rest of the Cabinet (on 1st November, I suggest rather than 25th October). Option 5 has the advantage of leaving the present Cabinet decision standing (and can thus be brought within the terms of the draft minutes attached). It will be entirely consistent with the Cabinet

SECRET

decision on 13th September, that, in the second Public Expenditure White Paper on later years, 'the tentative nature of the figures for later years should be emphasised'. (CC(79) 15th Conclusions, Minute 5). But I think you would want to explain to the Cabinet why the prevailing view this week has not been accepted. The attitude of the Chiefs of Staff provides one reason. Another might be the hint that Lord Carrington dropped in Cabinet about the attitude of the Party rank and file and backbenchers. You might even consider asking the Chief Whip to take a few soundings which would indicate that Party feeling would be an important factor. If the principal actors had been approached in advance, and the Cabinet were tackled in the way I suggest, you might then be able to reach a fairly quick agreement on the Defence Budget. You would need to consider whether to make it clear to Cabinet, and get it recorded, that this was an exceptional case, justified by the unique importance of the deterrent; it would not be a precedent for any other Minister to demand a pre-emptive claim on the contingency reserve.

10. As you know, I shall be at Chequers on Sunday and you may wish to have a further word then. Meanwhile, I suggest that you should resist any attempt by the Secretary of State for Defence or the Chancellor of the Exchequer to speak to you privately about this over the weekend. Your own position in this is too important to be compromised at the start, and I am sure it is best to operate at one remove, coming in yourself only when there is some prospect of an agreement.


(John Hunt)

19th October 1979

SECRET

ANNEX - OPTIONS

- OPTION 1: Publish "Biffen" figures: defend on Treasury lines.
- OPTION 2: Publish "Biffen" figures: admit fall short - though not much short - of our own past hopes but we are all we can afford in the light of our economic prospects/inheritance. Still our fastest growing programme.
- OPTION 3: Publish "Biffen" figures: explain as in Option 2 but add "hope to do better if our economic circumstances permit".
- OPTION 4: Publish "Biffen" figures: say all figures after 1980-81 provisional but we intend to adjust them to achieve 3 per cent volume target as period unfolds (we could pray in aid uncertainty about relative price effect in new economic circumstances - though same argument might apply to other programmes).
- OPTION 5: Publish "Biffen" figures; explain that they are less than 30 per cent by volume but make clear that they make no provision for replacement of deterrent, which would be an extra financed from the Contingency Reserve.
- OPTION 6: Publish "Pym" figures: allow public expenditure to rise accordingly.
- OPTION 7: Publish "Pym" figures: find offsetting savings elsewhere.
- OPTION 8: Publish "Pym" figures: adjust contingency reserve.
- OPTION 9: Publish "Pym" figures: adjust contingency reserve; have clear Cabinet understanding that figures for defence for year after 1980-81 will have to be decided in future PES reviews in light of circumstances - adjustment can be either way (de facto position but a Cabinet minute would ensure no later cries of "foul").

S E C R E T

Defence.

DEFENCE EXPENDITURE

1. The Defence figures in C(79)35:-
 - (a) rise by 3 per cent a year in cost terms from 1981/82 to 1983/84;
 - (b) rise by an average of 3 per cent a year in volume terms over the five years ending 1983/84;
 - (c) add £700m to the previous Government's planned figures for the last three years of the PESC period;
 - (d) raise the defence share of GDP from 4.9 per cent in 197 to over 5.5 per cent in 198 , and of total public expenditure from 11 per cent to 13 per cent.

2. By presenting our defence figures in cost terms, we bring our practice into line with most of our Allies. Our proposals can thus be fairly represented as consistent both with our Manifesto commitment and our undertaking to NATO. To make any change from the position now reached would cast grave doubt on our strategy for public expenditure - and on the firmness of our commitment to that strategy.

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB (CABINET OFFICE) CLASSES**.

Reference: Limited Circulation Annex to CC (79) 17th Conclusions,
Minute 5

Date: 18 October 1979

Signed Wayland Date 25 February 2010

PREM Records Team

Defence

REFERENCE Exp. sup 2

Top Copy on: Econ Pol,
Pt 5,
Pub. Exp.

PRIME MINISTER

Meeting with the Chancellor - Thursday 18 October, 0845

I understand the Chancellor may want to discuss the following issues with you tomorrow morning:

i) RSG Cash Limit for 1980/81

There is a minute on this at Flag A. This proposes certain assumptions on pay and prices for working out the cash limit. The pay assumptions (in paragraph 7) consist of estimates of what will be the effect of the outstanding Clegg awards, an assumption of 14% in other settlements up to end July 1980, and 12½% for settlements for the following year. On prices, the Chancellor proposes 13% - rather less than the Treasury's forecast/assumption for price increases generally. The purpose of this is to put some additional squeeze on the local authorities. MISC 21 have decided (see minutes at Flag B) that the RSG percentage should be 61%, as against 58% proposed by the Treasury. This, if endorsed by Cabinet, will reduce pressure for rate increases; on the other hand, it will mean more public expenditure than the Treasury were counting on. In order to soften the public expenditure effect of a 61% grant, it would be wise to have a tight cash limit, and therefore the Chancellor's proposals on pay/price assumptions seem right. (If they are too tight, the local authorities will not believe the pay/price assumptions on which they are based; and will again put up the rates by an excessive amount.)

ii) TV Licences

The Chancellor has agreed the Home Secretary's proposals for TV licence increases, which the Home Secretary discussed with you. These call for a £9 increase for colour sets from November and a £2 increase for monochrome sets; and they are to last for 2 years. You made various suggestions

/ to the Home Secretary

to the Home Secretary (record at Flag C) - such as that there should be no increase for monochrome sets if the monochrome licence falls largely on pensioners. I think it would be best to wait for a minute from the Home Secretary, in which he will no doubt cover your points, before taking any final decision.

(iii) NEDC Membership

You discussed this last time, and suggested that Sir Leslie Murphy should not be re-appointed and should be replaced by somebody from small businesses and that Mr. Shanks should be replaced by Daisy Hyams.

(iv) Gas Prices

The Chancellor will show you figures on the PSBR effect of delaying the gas and electricity price increases by one year - as suggested in E this afternoon.

(v) Defence Expenditure

There is a dispute between the Treasury and MOD about the interpretation of the 3% NATO commitment. The argument is continuing to range (as reflected in three minutes which are in the Cabinet folder). You told the Chancellor earlier that you would support him against Mr. Pym.

At last week's meeting with the Chancellor you asked for a note on additional demands for finance coming forward from the nationalised industries, Rolls Royce, British Leyland, etc. This is at Flag D. It shows that there are some substantial potential demands - in 1981/82 as much as £850 million - and this is on the assumption that the Chief Secretary's proposals to Cabinet for "cutting" expenditure are agreed, including the energy price increases. The note simply reinforces the importance of getting as much of the Chief Secretary's proposals on public expenditure through Cabinet as possible.

12.

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*Seen by PM
Defence*

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

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MO 8/2/12

PRIME MINISTER

DEFENCE EXPENDITURE

I have seen the Chancellor of the Exchequer's minute to you of 16th October. Let me say three things.

2. First I accept the basic necessity to constrain public expenditure as a central pillar of our policy, just as we all equally accepted the need to give priority to defence and law and order.

3. Second, the issue on which the Chancellor comments is a technical matter of presentation. We could go on debating it; but we must recognise it for what it is, namely a technical device which would be unique to defence.

4. Third, if we seek to use this device to justify increases lower than 3% in defence expenditure we are bound to be seen to be changing the rules in the middle of the game, and to be criticised accordingly. If the device were to be used for all our programmes and to become the basis of presentation in the Public Expenditure White Paper as a whole, then our hand would be stronger. But this is not the case.

5. Whatever increases we agree upon at Cabinet - and I shall argue in support of the bids I have made - we must be ready to explain them in the same terms as have been used in the past and which will be understood both in the Alliance and by our supporters, Parliament and the country at large.

6. I am sending copies of this minute to the Chancellor of the Exchequer, our other Cabinet colleagues and to Sir John Hunt.

J.P.

17th October 1979

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MINISTRY OF DEFENSE - GENERAL STAFF



170

[Faint, illegible text covering the majority of the page, likely bleed-through from the reverse side.]



Prime Minister

12

17/10

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

DEFENCE EXPENDITURE

I have two comments on the Defence Secretary's minute of 12th October, which deals with points which are largely covered in Annex E to John Biffen's paper C(79)42 which we shall be discussing in Cabinet on Thursday.

2. First, I cannot accept that John Biffen's proposals are 'a technical device for cutting back planned defence expenditure'. Lest there be any misunderstanding, I confirm that the Chief Secretary's proposals:-

- (a) add £700m to the previous government's published figures for the last three years of the PESC period: the point at issue is the Defence Secretary's wish to raise the addition to over £1bn;
- (b) mean that in the five years to 1983/84 defence spending, measured (as traditionally) in volume terms, will rise by 3 per cent a year on average.

3. Secondly, I cannot accept that John Biffen's proposals will be widely seen as 'a piece of sharp practice and as changing the rules while the game is in progress'. The facts are that:-

/(a) NATO has not



- (a) NATO has not decreed that the target of annual increases in defence spending 'in the region of 3 per cent' should be met in volume rather than cost terms: indeed few Allies publish, and NATO therefore does not collect, figures in volume terms;
- (b) by moving to cost terms we shall be coming into line with what the majority of our NATO Allies in practice do. I am not questioning the rules of the game, merely our previous idiosyncratic interpretation of them.

4. It will be for Cabinet to decide whether to accept the Treasury proposals, which involve Defence's share of GDP and total public expenditure rising from 4.9 per cent to over 5.5 per cent, and from 11 per cent to 13 per cent respectively. But it would be wrong for our decision to be affected by misunderstanding about their nature.

5. I am sending copies of this minute to the Defence Secretary, and other Cabinet colleagues, and Sir John Hunt.

A handwritten signature in black ink, appearing to be 'G.H.' with a flourish.

(G.H.)

16th October 1979

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2



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

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MO 8/2/12

Prime Minister

*For Cabinet on
Thursday.*

PRIME MINISTER

*(You told the Chancellor
that you would support the
Treasury on this issue)*

PL

14/9

DEFENCE EXPENDITURE IN THE PESC PERIOD

We are due to resume our discussions of public expenditure on 18th October. You are due to see Chancellor Schmidt on 31st October - the very day when the first Public Expenditure White Paper is planned for publication - and I am meeting Dr Brown on 13th November. Our decisions on defence expenditure will have important implications for our relations with our Allies, and I thought that I should explain the international and domestic political, considerations which lead me to continue to differ from the Chief Secretary's proposals in C(79)35.

2. The Chief Secretary is proposing volume increases in defence expenditure of 2.3%, 2.4% and 2.4% in the years from 1981-82 to 1983-84. He maintains that these increases can be presented publicly as meeting NATO's aim for real increases in defence expenditure of 3% per annum. His argument is that we can claim that the gap between his figures and the NATO 3% target will be filled by the extent to which defence prices are forecast to rise more quickly than the average price of GDP. In other words we will have to admit to NATO that we are failing to increase our volume of defence expenditure by the full NATO target of 3%.

3. I have discussed all this at length with the Chief Secretary. I have told him that I find his proposed

/ technical ...

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U.S.

Current Period

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F.R.



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37

Treasury says that our allies express their commitment in cost terms!

TL

technical device for cutting back planned defence expenditure utterly unconvincing. I believe that his proposal to tell NATO that henceforth we measure our commitment in cost rather than volume terms will not deceive our Allies, who are inevitably looking very closely at what we are doing and proposing to do on the 3%; and it will not appear in any way satisfactory to informed observers of the scene. Nor will it be received well by our supporters in Parliament and in the country, to whom we have now made very clear our commitment on this issue. All will regard the device as a piece of sharp practice and as changing the rules while the game is in progress.

We will achieve 3% growth but from a lower base than Labour were planning

TL

4. Their reactions will be the sharper because it will become evident from the first Public Expenditure White Paper that the agreed figure of £8,062m for the defence programme in 1980/81 constitutes a reduction of over £100m compared with Labour's planned figure for that year of £7,394m, which on a comparable price basis would be £8,177m. There is no doubt that we could mitigate the effect of the reduction in 1980-81 if we could resume the 3% volume growth path in the subsequent PESC years. To do so would establish a position of strength in our discussions with the Germans and Americans. A clear commitment to the NATO 3% guideline is the one measure that would count to our advantage in our talks both now and in the future with both countries.

5. The Americans have already been in touch with us, seeking our good offices in putting pressure on the Germans to improve their performance. It would be difficult to do this directly. But we could certainly do so by example; and this would be seen by the Americans as an important act of friendship and co-operation in the achievement of the needs of Western security. This could be very important in any future discussions we might have with them on defence matters.

/ 6. ...

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3

6. In our discussions about public expenditure in the years ahead we must take account of these wider considerations of our standing with our important Allies. But 3% a year real growth is, of course, needed not only for the presentational reasons explained above. We are as a Government agreed that a real and sustained increase in defence expenditure is needed if we are to play our proper part in combatting the Soviet threat, and to enable us to make the necessary improvements to the programme to this end. By safeguarding our own defences we shall also make a contribution to our standing in the eyes of our Allies and thus contribute to the achievement of our further objectives.

7. I am sending copies of this minute to the Chief Secretary, our other Cabinet colleagues, and Sir John Hunt.

12th October 1979

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CONFIDENTIAL

12 OCT 1973

11 12 1 2 3 4 5 6 7 8 9 10

The meeting on the 12th of this month to the City
Council, for the purpose of the City Council, and the Council.

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CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

25 September 1979

Defence MFT
of M. Ude

Copies on Master.

My separate letter of today's date records the conversation which the Prime Minister had with Treasury Ministers and the Governor concerning the domestic monetary situation and exchange controls when they had lunch together yesterday.

see
Econ. Pol.
Domestic Monetary
P. 2.

There was also a short discussion about public expenditure. The Chief Secretary reported on his bilaterals with the Secretary of State for Defence and the Secretary of State for the Environment. In connection with the former, he said that there was an unresolved dispute over the definition of our commitments to NATO. The MOD argued that we had to show that we were planning a 3 per cent annual increase in spending in volume terms, whereas the Treasury argued that the 3 per cent should be defined in cost terms (allowing for the relative price effect). The cost approach was the one used by our allies, and there seemed no reason why we should not do the same ourselves - even though, as MOD argued, we had hitherto expressed our defence spending for NATO purposes in volume terms. This issue would probably have to come back to Cabinet.

The Prime Minister said that, as far as she was concerned, the Treasury line was right.

SB.

T. P. LANKESTER

M.A. Hall, Esq.,
HM Treasury.

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Defence

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

CONFIDENTIAL

MO 8/2/12

20th September 1979

Dear John

1. Mr Alexander

2. P.A.

*12
20/9*

DEFENCE CASH LIMITS 1979-80

Thank you for your letter of 11th September. I agree to the calculated addition of £140m to the Defence cash limit which you suggest. Supplementary Estimates and the necessary explanations can now be prepared and agreed between our officials.

The final paragraph of your letter implies that the overspend against the Defence cash limit in 1978/79 may be the result of defects in financial control procedures, though I take it from your second paragraph that you were aware (though our OD colleagues may not be) that the year ended in the middle of a strike of computer operators which lasted for almost three months, depriving us of our normal sources of information. Even so, our emergency arrangements, which my officials discussed in advance both with your officials and with the Exchequer and Audit Department, would not have resulted in an overspend had it not been for two unforeseen factors:-

a. Picketing, some of it secondary picketing, cut off postal deliveries, with the result that about £10m was not brought to account in 1978/79.

/ b. ...

The Rt Hon John Biffen MP

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2.

b. Some contractors, as we had foreseen, sought advances uncovered by timely bills. We had assumed that in conformity with the way in which similar cases had been treated in the past such advances would not be chargeable to 1978/79 but to 1979/80. In July however the Exchequer and Audit Department concluded that these payments, totalling £64m, should be charged to 1978/79. My officials, after informing the Treasury, decided to comply with this ruling.

These facts provide a valid reason for adjusting our 1979/80 cash limit in the way suggested in your letter. They do not give grounds for suggesting that our management procedures are defective. On the contrary they emphasise the need, which my officials have been stressing for some years past, for introducing some controlled measure of flexibility into the cash limits system. It is very much to be hoped that the studies which Sir Derek Rayner is conducting (mentioned in your letter to the Prime Minister of 11th September) will enable a cash limits doctrine to be evolved which is more closely related to the management realities of a department such as mine.

I am copying this letter to the other recipients of yours.

Francis Pym
Francis

Francis Pym

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20 SEP 1979

SECRET



Copy No 2 of 26 Copies

2

Page 1 of 2 pages

Defence

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

SECRET

12th September 1979

MO 8/2/12

Handwritten notes:
to Mr Alexander
2. pa.
R
12/9

Dear John,

DEFENCE EXPENDITURE 1981-82 TO 1983-84

You explained in your letter of 11th September why you thought that it would be right to place a new interpretation on the undertaking we have given to NATO that defence expenditure should grow at a rate of 3% per annum.

I am afraid that the formula you propose, ingenious though it is, cannot in my view be reconciled with the undertakings we have given. The simple fact remains that the figures in the White Paper will show, as you point out, increases of 2.3%, 2.4% and 2.4%. Is it seriously expected that our supporters, our political opponents, and our allies alike will accept that these figures "really" represent an increase of 3%?

I accept, as you suggest, that our method of presenting public expenditure plans exposes the truth about our intentions in a way which our allies' practices fail to do. The fact remains, however, that in the past both our own party and the Labour party have presented expenditure plans in constant price terms, and for us to cast doubts upon the practice now in the way you suggest, would be seen as a cut in defence and reneging on the undertaking which I was authorised by my colleagues to give in NATO in May.

/ Even ...

The Rt Hon W J Biffen MP

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SECRET



SECRET

2.

Even our Labour predecessors accepted that meeting the NATO 3% target was a commitment in volume rather than cost terms, and published their plans accordingly. I am afraid therefore that I find the proposal in the Cabinet paper unacceptable.

I am sending copies of this letter to our Cabinet colleagues and to Sir John Hunt.

Francis Pym

Francis

Francis Pym

SECRET

SECRET

11.2 SEP 1979





1. to Alexander
2. ~~to be sent to...~~

R
12/9

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Francis Pym MC MP
Secretary of State
Ministry of Defence
Main Building
Whitehall
London SW1A 2HB

ASB

11 September 1979

Dear Francis,

Defence Expenditure 1981-82 to 1983-84

(29)35

The paper which the Chancellor and I have circulated for Cabinet on Thursday about the later years of the Public Expenditure Survey include figures for Defence which provide for a 3% rate of growth "in cost terms". This letter is to amplify this and explain why we believe - and hope that you will accept - that it is a legitimate interpretation of our NATO commitment.

i.e. ~~the~~
the cost
of this
programme,
like the
programme,
is rising
faster
than
prices
generally.

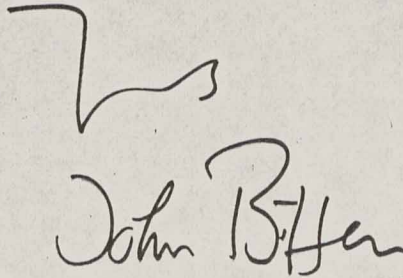
What we propose is that we should take credit, towards the 3% target, for the positive relative price effect which occurs on the Defence Programme. In this field the UK penalises itself by publishing plans and outturns in strict volume terms and so interpreting the NATO commitment. Most countries publish only cash figures which can be deflated only by a general price index, producing what we would call "cost terms" figures.

We ought to come into line. It is absurd that we should not take credit in NATO for the major increase in Forces' pay which we agreed in May. If we were to do so Defence spending in 1980-81 could have been several hundred million pounds lower than the figure we agreed in July, while remaining fully consistent with the NATO target.

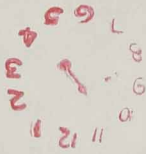
Officials currently estimate that the relative price effect on the Defence Programme in 1981-82 to 1983-84 is likely to be around $\frac{2}{3}$ rd per cent per annum on average. The figures we are proposing would accordingly reduce the volume increases in the Defence Programme in those years to 2.3%, 2.4% and 2.4% respectively. Even if the figures which we have for the performance of other NATO countries in relation to the target were in volume terms, these increases would not compare badly with them.

The NATO target speaks of "increases in the region of 3%" and recognises that "for some individual countries, economic circumstances would affect what could be achieved". Since next year we shall overtake the United States at the top of the NATO league in terms of proportion of national income devoted to Defence, and since the difficulties of the economic situation we inherited are well understood, a UK derogation could easily be defended. But this is not what is now envisaged. We merely propose that the NATO target should be interpreted in a way which is reasonable in itself and defensible in terms of what other countries do.

I am sending copies of this letter to our Cabinet colleagues and to Sir John Hunt.

A handwritten signature in dark ink, consisting of a stylized initial 'J' followed by the name 'Biffen' in a cursive script.

JOHN BIFFEN



17 SEP 1979



2
 1. Mr. Alexander
 2. Finance Minister

You should be
 aware of x.

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Francis Pym MC MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

12
 129
 11 September 1979

Dear Francis,

DEFENCE CASH LIMITS 1979-80

As proposed in your minute of 13 July to Geoffrey Howe, our officials have been discussing what increase in your cash limits for the current year would be appropriate, given the Prime Minister's decision that compensation should be allowed for the indirect tax increases announced in the Budget. They have also taken into account the estimated cost of the industrialists' pay award as well as certain other minor eligible items. The total in question was assessed as £212 million.

Against this it appears that, largely as a result of the unusual circumstances prevailing at the turn of the financial year because of industrial action affecting the payment of bills and the booking of receipts, your Ministry overspent their cash limit in 1978-79 by about £74.5 million. Given the importance we as a Government attach to the cash limit system, I consider that we must now make at least a roughly equivalent reduction in your cash limit for 1979-80.

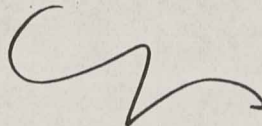
I am therefore now prepared to approve a net addition of £140 million. If you agree, the new total of your cash limits will become £8553.6 million. I must ask you to ensure that your expenditure does not exceed this figure.

This addition can be announced together with other adjustments to cash limits when Parliament reassembles. It will be necessary to ask Parliament to approve a supplementary estimate. There should be no difficulty in explaining the addition: the increase on account of VAT was foreshadowed in your reply to Winston Churchill's PQ on 10 July, and the adjustment on account of the overspend will be readily understood. Our officials can be asked to agree the text of the announcement.

CONFIDENTIAL

Our officials are in correspondence about the precise explanation for the overspend last year. We shall need to consider, in the light of their findings, whether any further action is indicated, for example in regard to your financial control systems.

I am sending copies of this letter to members of OD Committee and to Sir John Hunt.



John Biffen

JOHN BIFFEN

CONFIDENTIAL

CONFIDENTIAL



Defaca

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALING 01-218 2111/3

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177

CHANCELLOR OF THE EXCHEQUER

At the conclusion of MISC 11 this morning I undertook to think further about the points brought out. We discussed these subsequently on the telephone.

2. For 1979-80, the problem is to determine what should be added to our cash limit to take account of the Prime Minister's decision, recorded in her Private Secretary's letter of ~~9th~~ July, that an exception must be made for defence in respect of the additional burden which the VAT and petroleum duty increase has imposed. There will also be an addition for the outstanding civil pay increases. I regard these as matters of straightforward calculation, and I suggest that officials should settle them.

3. For 1980-81, as I explained, NATO will be expecting to see in the next Public Expenditure White Paper a figure corresponding to my claim of £8,265M. (This is calculated by taking the Survey baseline (ie Labour Government) figure for 1979-80 of £7927M, adding the £100M announced at the time of the Budget to produce £8027M, and then adding 3% to bring the bid to £8265M). Anything less than £8265M will result in accusations of bad faith, and could be seized upon by our critics as evidence that our Manifesto undertaking is not being honoured.

4. However, I recognise the difficulties that face us all in the economic sphere, and you and the Chief Secretary in particular. I am prepared to play my part in explaining the limitations they place upon the policies of the Government as a whole even though this would entail conceding that despite all our protestations we are not able to make real improvements on the programme that we criticised so heavily when in Opposition.

/ 5. ...

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CONFIDENTIAL



CONFIDENTIAL

2

5. For this reason I would be prepared to accept a volume plan figure for 1980-81 of £8190M ie a cut of £75M on what I need; and a figure which is only £13M above the Labour Government's baseline figure for 1980-81. I must however set one condition; when it comes to turning this volume figure into cash limits I must have a full and fair addition, without any additional volume squeeze and taking full account of our past experience - the cash limit has significantly under-provided volume needs in every year of the system's operation. I must ask for this to be avoided in 1980-81, and for the reservation in paragraph 6 of the Chief Secretary's paper C(79)26 not to apply to defence.

6. My proposal involves putting off the start of the improvements in our defences which we had intended; I make it as my contribution to our common difficulties. I hope that you will agree that it is as far as we can safely go in the context of the country's security.

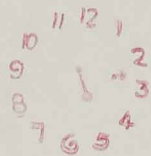
7. I am copying this minute to my OD colleagues, to the Secretary of State for Trade, the Chief Secretary and to Sir John Hunt.

13th July 1979

CONFIDENTIAL

CONFIDENTIAL

16 JUL 1979



CONFIDENTIAL



48
Defence

10 DOWNING STREET

From the Private Secretary

12 July 1979

Defence Cash Limit

The Prime Minister has read the Chief Secretary's minute of 11 July on the above subject. The Prime Minister has asked me to say that, although she had indeed agreed that there should be no easement of the cash limits policy on account of the higher prices in the post-Budget forecast, on reflection she felt that an exemption for defence was necessary. However, she will certainly support the Chief Secretary in resisting proposals from other Ministers to increase their cash limits on account of the tax increases in the Budget.

The Prime Minister has also asked me to point out that the decision that there should be no easement of cash limits was not taken in Cabinet, and therefore the question of re-opening Cabinet decisions does not arise in this case.

~~M. A. PATTISON~~

T. P. LANKESTER

A.C. Pirie, Esq.

CONFIDENTIAL

Handwritten initials

PRIME MINISTER

Defence Cash Limit

This minute from the Chief Secretary, which has not been copied to other Ministers, is in response to your decision that the defence cash limit should, if necessary, be increased to compensate for the VAT and petroleum duty increases in the Budget. Mr. Biffen does not challenge your decision. However, he asks if he can count on your support if necessary in resisting proposals from other Ministers to break the discipline of cash limits, or to re-open decisions taken in Cabinet.

In fact, as I explain in my manuscript note at the end of Mr. Biffen's minute, no decision was taken in Cabinet against compensating departments for the tax increases in the Budget. You did endorse the Chief Secretary's line earlier, but there was no reason why Mr. Pym should not object to it - although he could have done so sooner. So there is no question of decisions taken in Cabinet being re-opened.

Shall I say that -

- (i) On reflection, you felt an exemption for defence was necessary; *Yes*
- (ii) You will support the Chief Secretary in resisting proposals from other Ministers to increase their cash limits; *Yes*
- (iii) The decision was not taken in Cabinet, and therefore the question of re-opening Cabinet decisions does not arise? *Yes*

11 July 1979

Prime Minister



PRIME MINISTER

DEFENCE CASH LIMIT

TPM

*You have
this in your
box
TL*

As you will have seen from my letter of 10 July to the Defence Secretary, I have taken action in accordance with your view that, in the case of defence, we should go back on the previous Cabinet decision to hold cash limits for this year against price increases, including VAT.

2. But I must tell you of my regret and concern that we should be doing this.

Play A

3. Of course I recognise and accept our policy to help defence, and to maintain our international obligations in this field. But we have already done a lot for defence. As pointed out in my minute of 3 July, our decision on the pay award and the allocation of an additional £100 million to procurement have already increased the defence cash limits for the current year by £409 million. Now, although I intend to explore further with the Defence Secretary whether he could not manage with somewhat less, we look like announcing the addition of a further £180 million.

4. This is a significant amount by which to increase the PSBR this year. And it has a knock-on effect by raising the base from which the 3 per cent NATO commitment is calculated. Thus it removes at once about £200 million of the savings which I had in mind to make up the target of £6½ billion proposed in my paper for Cabinet this week.

5. We must also be careful about repercussions on the credibility of the cash limits system and the discipline which we intend the

system to impose. This applies both in the field of defence and generally. Cash limits depend on the understanding that once fixed, they will not be readily reopened.

X 6. I hope I can count on your support if necessary in resisting proposals from other Ministers to break the discipline of cash limits, or to reopen decisions taken in Cabinet.

7. The Chancellor of the Exchequer is aware of and agrees with this minute, but I am not copying it more widely.

W. J. B.

JOHN BIFFEN
11 July 1979

X The decision on cash limits - i.e. not to compensate Departments for the VAT increase - was not actually taken in Cabinet. The Chief Secretary ^{7/16/79 on Econ PA.} circulated a minute to this effect (Flag B) ^{(Put Exp) P42} which you endorsed and ^{to} which no Ministers raised any objection at the time.

12.



17 JUL 1979

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✓ In letter



Prime Minister

2

To note.

R

1979

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Francis Pym MC MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

10 July 1979

Z

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Dear Secretary of State,

DEFENCE CASH LIMITS 1979-80

In the light of the Prime Minister's view (No 10 letter of 9 July) that the Government's agreed and announced policy concerning VAT etc and cash limits should now be changed to provide for a special exception for defence, I have considered how best to do this.

The idea of introducing a clause into the Finance Bill to provide for exemption from or a special refund of the taxes does not look appropriate or feasible. I think we have to adjust your cash limits.

We shall no doubt need a talk anyway after Cabinet this week about the defence programme. Let us have a word then about precisely when and in what terms the further increase in your cash limit should be announced. Meanwhile I have no objection to your proposed reply to Mr Churchill's PQ, but I ask you please to substitute the following for the last two sentences of your draft, perhaps having deleted "nevertheless" in the sentence before:

"The cash limits will however be adjusted to the extent necessary to ensure that the essential needs of the defence programme are not prejudiced by these tax increases, subject to Parliamentary approval for any necessary additional funds".

As a consequence of this decision, for purposes of our discussion in Cabinet on Thursday I am reducing my proposed cut in the plans for the defence programme in 1980-81 from £300 million to £115 million, so that you can maintain a figure for 1980-81 consistent with the NATO 3 per cent target.

I am sending copies of this letter to the Prime Minister, to other members of the OD Committee, to the Lord President and Sir John Hunt.

Yours sincerely
 Achine

pp JOHN BIFFEN

[Approved by the Chief Secretary
 and signed in his absence]

CONFIDENTIAL



Defence
NBIM - too late!
R
9/7

PRIME MINISTER

DEFENCE CASH LIMITS 1979/80

In his minute of 5 July the Defence Secretary suggests that if the Defence Budget were not compensated for VAT we could be accused of making a 3% cut in defence spending, instead of a 3% increase.

2. Not so. It is true that the volume outturn in 1979/80 might show a shortfall against plan of around 3%. But some degree of shortfall is quite normal. In 1978/79, for example, the shortfall was 2.6%. The relevant comparison is between the expected outturn in 1979/80 and the outturn in 1978/79, and this looks likely to show an increase still of 2.2%.

3. There is a further point.

4. The paper on public expenditure which I am circulating to Cabinet today includes a proposal for a £300m reduction in the planned Defence Budget figure for 1980/81. This reduction, unpalatable as it would be, will still maintain a 3% increase on what we now expect to be the outturn in volume terms in the current year. If the Defence cash limits were now increased, this expected volume shortfall would not be achieved. We should lose the option of presenting the proposed reduction in 1980/81, which we certainly need to sustain the desired total of cuts, as consistent with the NATO target.

5. I am sending copies of this minute to the Defence Secretary, to other members of OD Committee, the Lord President and Sir John Hunt.

Atkin
P.P. JOHN BIFFEN (approved by the
9 July 1979 Chief Secretary and
signed in his absence)

- ✓ c.c. Chief Sec.
- ✓ LPO
- ✓ CO
- ✓ HO
- ✓ LCO
- ✓ FCO
- ✓ Tsy
- ✓ LPS
- ✓ DT



c.c. Mr. Cartledge

Defence

10 DOWNING STREET

From the Private Secretary

9 July, 1979.

Mr. Poye.

Defence Cash Limit 1979/80

The Prime Minister has considered your Secretary of State's minute of 2 July on the above subject, and also his further note of 5 July. She also considered the Chief Secretary's minute of 4 July. The Prime Minister has asked me to say that an exception must be made for defence in respect of the additional burden which the VAT and petroleum duty increase has imposed. She believes that it would be wrong to be seen to be taking out more in VAT and petroleum duty than had been added to the defence cash limit by way of additional provision when the Government took office. The Prime Minister has directed that if possible the defence programme should be exempted from the VAT and petroleum duty increase; or alternatively, the VAT and petroleum duty increase should be balanced by an increase in the cash limit later in the year.

recipients informed of correction

Your Secretary of State should therefore be in a position to state publicly, as and when ^{occasion} action requires, that the tax increases in the budget will not lead to cuts in the defence programme.

I am sending copies of this letter to Alistair Pirie (Chief Secretary's Office, HM Treasury), the Private Secretaries to OD Ministers, Jim Buckley (Lord President's Office), and Martin Vile (Cabinet Office).

Tom

Tin Linn

✓ R.L.L. Facer, Esq.,
Ministry of Defence.

CONFIDENTIAL

21

PRIME MINISTER

cc: Mr. Cartledge

DEFENCE CASH LIMIT 1979-80

These papers involve a dispute between the Treasury and the Ministry of Defence about the application of this year's defence cash limit. They are asking you to adjudicate.

Mr. Pym (Flag A) is complaining that the VAT and petrol duty increase will add £180 m. to defence costs in the current year. He would like, if pressed, to be able to say that - if necessary in order to maintain the level of defence spending in real terms - additional funds will be provided during the course of the year. His argument is that the £180 m. additional cost more than outweighs the £100 m. extra provision which was given when the Government took office. The effect of this is further spelt out in his subsequent minute (Flag B).

The Chief Secretary (Flag C) argues that this would be directly against our cash limits policy; and more specifically, it would conflict with the policy that "there should be no easing of the cash limits policy as already decided and announced on account of the higher prices in the post-Budget forecast". The Chief Secretary, with your agreement, minuted colleagues to this effect before the Budget (Flag D), and Mr. Pym did not dissent at the time.

This is difficult. If the manifesto commitment to improve our defence effort is to be implemented this year, MOD will almost certainly need some additional funds later in the year; and Mr. Pym does indeed appear to be under some pressure to make his position clear. On the other hand, any such indication at this stage would undermine the Chancellor's posture on cash limits, and would suggest to some that the Government was going to relax on other cash limits when the going gets tough. One way out would be for the Chancellor to relax the defence cash limit so as to compensate for the indirect tax increases; but to find some offsetting savings elsewhere. However, I cannot believe this is feasible.

/ Do you

Do you wish to stand by your earlier decision that there should be no easement of cash limits, including MOD's; or will you agree that Mr. Pym should say, if necessary, that the tax increases will not lead to cuts in the defence programme (and by implication the cash limit will be adjusted upwards)?

R
..

We are not going to demoralise
the whole of our Armed Services ~~just~~
~~because we have put up~~ by taking
out more in V.A.T. than we added in
cash limit. We then except them for
the V.A.T. increase (if possible) or balance
it out by increasing the cash limit, defence
is different from other departments.
R.P.

6 July 1979

CONFIDENTIAL

MR. LANKESTER

R 617

Defence Cash Limit 1979-80

The Chief Secretary, Treasury has now commented on the minute of 2nd July from the Secretary of State for Defence. There are two points you might like to make in putting these papers to the Prime Minister:-

- (a) On the immediate question of the Budget changes, the Chief Secretary took the Prime Minister's views on this in his minute of 4th June, and you said (your letter of 5th June to Alister Pirie) that she agreed 'that there should be no easement of the cash limit policy as already decided and announced on account of the higher RPI in the post-Budget forecast. She also agrees that Ministerial colleagues should be warned of the extra volume squeeze which this will imply ...'. Unless the Prime Minister is persuaded by Mr. Pym's latest minute that she should change her view on this, we assume that decision still stands. As the Chief Secretary will no doubt say, any special exemption from the existing cash limits for the Ministry of Defence would open up a whole series of similar claims. Equally, the Secretary of State for Defence has a strong case for special treatment, given that the Budget cuts wipe out much of the extra benefit he was given immediately after the Election, and the level of the Defence Budget has been frequently changed in the past, usually downwards, by the applications of considerations to which other spending programmes have not been subjected.
- (b) But this case does not stand in isolation. The Secretary of State for Defence has also pleaded for special treatment for his Votes to take account of the cost of the impending pay increase for the industrial Civil Service (and 70 per cent of that falls on his Votes directly). No decision is needed on that point yet. For the moment, Treasury and CSD Ministers are assuming that the Cabinet's earlier decision,

see
Gen Prol (Pub Exp)
Pt 2.

CONFIDENTIAL

to increase the cash limits would accommodate the settlement, but then to abate them by 3 per cent to take account of the extra cost of pay will stick. But it is relevant to the position of the Defence Budget that a number of our NATO allies e. g. West Germany may not regard the special treatment accorded to the Armed Services pay award as a true addition to the level of United Kingdom defence expenditure.

This is another illustration of the conflict of priorities between the Defence programme and the cash limit policy. And if it is not resolved in the way the Secretary of State for Defence wants, this issue might come to the Prime Minister's notice.

MJV

(M. J. Vile)

6th July, 1979

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6 JUL 1979

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MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALING 01-218 2111/3

CONFIDENTIAL

MO 8/2/12

PRIME MINISTER

DEFENCE CASH LIMITS 1979-80

I must make a short comment on the Chief Secretary's minute on Defence Cash Limits 1979-80.

- ✓ 4.7
2. It is quite wrong to suppose that our Allies will think of the tax increases as a small debit factor offset by the credits of the Forces' pay increases and the £100m.
 3. The Germans and Americans can do the calculations as well as we can. They will know that, if VAT has to be absorbed (as well as 3% of the civilian pay bill, which I have accepted) there is no way in which the 3% NATO target could be met. In fact, on the figures and prices to date, we shall be making a 3% cut. We cannot ensure our political standing by dishonouring an undertaking given little over a month ago. To fail to stand by the commitments we have so recently made would dismay our friends and give comfort to our opponents both domestically and internationally.
 4. I am sending copies of this minute to the Chief Secretary, to other members of the OD Committee, the Lord President and Sir John Hunt.

5th July 1979

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CONFIDENTIAL

-5 JUL 1979



CONFIDENTIAL



PRIME MINISTER ✓

DEFENCE CASH LIMITS 1979/80

The Defence Secretary wrote to you on 2 July seeking an assurance that the defence cash limits would be further supplemented if in the event it proved impossible to absorb the additional costs imposed by the indirect tax increases without reining back the defence programme.

2. I am sure we should not make a public statement now which could be taken to indicate that the Defence Budget will be given special relief from the discipline of cash limits.

3. You will recall our exchanges before the Budget. Your Private Secretary wrote to mine on 5 June ^{see: Econ. Pol., Pt 2, Pub. Exp.} recording your view that there should be no easement of the cash limits policy as already decided and announced on account of the higher prices in the post-Budget forecast, but asking me to inform colleagues of the extra volume squeeze which this would imply. This I did in a minute of 8 June. ^{see: Econ. Pol., Pt 2, Pub. Exp.} No objections were raised at the Cabinet meeting which endorsed the Budget proposals.

4. To re-open the matter now would cast doubt on our Budget strategy and on our ability, and will, to maintain the control of public expenditure through the cash limits which is an essential part of our strategy. We cannot relieve a major programme, however important in its own right, from the constraints of cash limits without prejudicing the system. And we very much want to avoid adding to the borrowing requirement in the present year.

Con't.....

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4. It is not my field but I question the degree of criticism to be expected from our Allies. Of course they will ask questions, but at the political level our standing will surely remain high following our endorsement of the 3% target. There are some good points we can make:

- (i) we have just increased the defence cash limits for the current year by £409m -- substantially more than the cost of the tax increases; this included financing in full the generous pay award to the Armed Forces and protecting essential elements of the Defence Budget by allocating an additional £100m to equipment procurement;
- (ii) the extent of the volume squeeze resulting from the cash limits will depend on the rate of inflation; it is not something peculiar to the United Kingdom, but common to all countries which set their budgets in cash terms.

5. I must therefore recommend that the Defence Secretary should give no assurance that the Defence Budget will be compensated in the way he suggests.

6. I am sending copies of this minute to the Defence Secretary, to other members of OD Committee, the Lord President and Sir John Hunt.

WJB

JOHN BIFFEN (3.7.79)

JUL 4 1979



MEMORANDUM

TO :

FROM :

SUBJECT :

CONFIDENTIAL



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

CONFIDENTIAL

MO 8/2/12

PRIME MINISTER

DEFENCE CASH LIMIT 1979-80

You will have seen my minute of 20th June and John Biffen's reply of 26th June about the effect of the Budget increases in VAT and petroleum duty on the current year's defence programme. I am afraid this presents us with a serious problem.

2. These increases will cost the defence budget an additional £180m or so in the current year, including the defence works programme for which the Property Services Agency is responsible. No other Department faces a comparable cost; I understand that the Department of Health and Social Security come closest, with some £50m.

3. The cash limit fixed by our predecessors was inadequate to finance the programme; when we took office we found that because of rising inflation we were heading for a squeeze of over £200m on defence equipment, stores and supplies. The Cabinet accordingly agreed to an increase of £100m in the defence budget. The rest of the squeeze - over £100m - I have to absorb through administrative savings. I also have to cope with the 3% cut in manpower costs which applies to all Government Departments.

4. These challenges I have willingly accepted. But the new increases are in a different category. John Biffen is in effect saying that I must bite the bullet and live within the cash limit agreed before the Budget. If this line is maintained the result would be a real reduction in purchases

/ of ...

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of goods and services and would amount to a deliberate decision to dishonour our undertaking to our NATO Allies. Since defence is the programme most affected such a decision would discriminate against defence and would be seen to do so, contrary to our policy and pledges.

5. This would put the Government in a thoroughly invidious position. Our supporters would not understand why, after all we have said about strengthening defence, the defence programme for the current year should be cut to a level well below that publicly announced by our predecessors. I had to give a stalling answer to Winston Churchill's Written Question last Thursday. Our opponents also stand ready to exploit the situation. John Gilbert, the Minister of State here in the last Administration who took a personal interest in VAT, has a Question down for today. NATO too would realise what is going on - they monitor the performance of all Alliance members against the 3% undertaking.

6. The United States' Embassy were also on to the point a few days after the Budget.

7. To sum up: the Treasury line, if maintained, will effectively cut this year's defence budget by some £180m, contrary to our pledges. It will far more than counter the £100m increase for which we have taken credit, which would in reality be no more than a partial offset for inflation, and would in no way have enhanced the programme. The position will be plain to our supporters and critics alike.

8. I recognise the Treasury's difficulties and do not seek an increase in the cash limit now. I do however ask that, if it becomes clear later in the year that further funds are necessary to prevent further cuts in the defence programme which would otherwise have resulted from the tax increases, additional funds will be provided; and that meanwhile we should state publicly, as and when occasion

/ requires ...

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3

requires, that the tax increases will not lead to cuts in the defence programme.

9. I am copying this minute to the Chief Secretary, OD colleagues, the Lord President and Sir John Hunt.

A handwritten signature in black ink, consisting of stylized initials and a horizontal line below.

2nd July 1979

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2 JUL 1979

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JL to see 9/2
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Defence
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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Francis Pym MC MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

29 June 1979

Dear Francis

THE EFFECT OF BUDGET MEASURES ON CASH LIMITS

Thank you for your letter of 28 June.

I cannot agree with the answer you wish to give to Winston Churchill's question. The facts are that:-

- a. The decision to increase the Defence Budget by £100 million means that the volume squeeze imposed by the indirect tax changes will be mitigated to that extent; the Defence Budget is in practice bigger by £100 million than would otherwise have been the case, and this is precisely what the Government intended.
- b. The Government has taken no decision to relax the defence cash limit if it proves inadequate to maintain the essential defence programme, and it would be misleading Parliament to imply otherwise.
- c. We should not imply that such further changes in the cash limits as may be agreed are intended to cover anything other than subsequent pay settlements not yet concluded.
- d. As I said in my letter of 26 June, any relaxation of particular cash limits now would seriously damage the effective control of public expenditure which is essential to our budgetary and tax strategy.

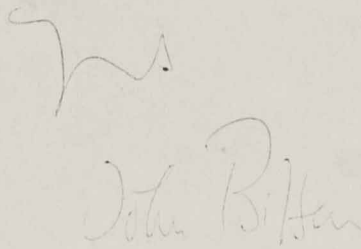
I shall of course be glad to discuss these points further with you on Monday if you wish. In the meantime however I think

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that the reply to Winston Churchill should be along the following lines:-

"The cost to the Defence Budget of the increase in VAT is estimated at £180 million in 1979/80. Earlier this week My Rt Hon Friend the Chief Secretary to the Treasury announced increases in the defence cash limit for 1979/80 totalling £409 million (Cmnd 7604). In view of the importance of greater efficiency and economy throughout Government, I intend to contain expenditure within the revised limits, and to ensure that the essential needs of the defence programme, to which the Government attach particular priority, are met."

I am copying this letter to the recipients of yours.

A handwritten signature in cursive script, appearing to read "John Biffen". The signature is written in dark ink and is positioned above the typed name.

JOHN BIFFEN

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29 JUN 1979



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Defence

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 218 2111/3

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28th June 1979

Dear John,

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28/6*

THE EFFECT OF BUDGET MEASURES ON
CASH LIMITS

Thank you for your letter of 26th June about the effect on the defence budget of increases in VAT and petroleum duty.

You refer to the Government's decision to maintain and enforce the cash limits but make no mention of the equally firm Government decision to increase our defence effort. I do not see how we, as a Government, can defend a position in which we have made much play in public of our decision to increase the defence budget by £100M and at the same time take an action which effectively cuts the defence programme by nearly £200M, still more as the £100M does not enable us to add to the defence programme but merely to keep it going without cuts, thanks to the failure of our predecessors to provide enough funds for the programme in their cash limit. Since my Department is the largest Government purchaser of goods and services, affected much more than others by the increases in VAT and petroleum duty, I shall have to reveal, in answer to a question from Winston Churchill today, by how much, and the formula you propose will in no way deal with the other part of Churchill's question, which is to ask what is the net increase in defence expenditure proposed for the current year. There will be no way of concealing that we are in fact proposing a net reduction of nearly £100M.

I believe, therefore, that to take any other course in public than that proposed in paragraph 3 of my minute of 20th June to the Chancellor of the Exchequer is to invite immediate criticism among Government supporters and from our Allies.

I must therefore urge you most strongly to consider the matter again, in the light of the wider issues and the credibility of Government policies generally. I am not

/asking ...

The Rt Hon John Biffen MP

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asking that the defence cash limit should be increased now, only that we should be prepared to say now that if it becomes clear during the course of the year that further funds are needed to maintain the essential defence programme on the basis which has already been agreed by Cabinet, the Government would seek the necessary Parliamentary approval. I attach the answer I should like to give to Churchill.

I am copying this letter to the Prime Minister and other members of OD, the Lord President and Sir John Hunt.

Francis Pym

Francis Pym

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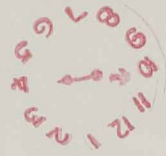
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Mr Churchill - To ask the Secretary of State for Defence what is the estimated effect on the defence budget of the increase in Value Added Tax announced in the budget; and what is the net increase in defence expenditure proposed for the current year?

Proposed Answer (Mr Pym)

The cost to the defence budget of the increase in VAT is estimated at £180M in 1979-80, including £3M for petroleum. Earlier this week my Rt Hon Friend the Chief Secretary to the Treasury announced increases in the defence cash limit for 1979-80 totalling £409M (Commd 7604). These increases were not specifically related to VAT or oil duties. My Department will nevertheless endeavour to contain expenditure within the revised cash limits, subject to such further changes as may be agreed, and will thereby contribute to the search for greater efficiency and economy throughout Government. If later in the year it should become clear that further funds are required to meet the essential needs of the defence programme, the Government will seek Parliamentary approval accordingly.



28 JUN 1979



Defence

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20/6

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Francis Pym MC MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

26th June 1979

Dear Francis,

THE EFFECT OF BUDGET MEASURES ON CASH LIMITS

Your minute of 20 June to the Chancellor of the Exchequer referred to the additional volume squeeze on public expenditure which arises from the increases in VAT and petroleum duty which were announced in the Budget.

It was with this point in mind that I circulated my minute of 7 June to the Prime Minister and Cabinet colleagues. I was concerned that colleagues should be aware, before our discussion of the proposed Budget measures on 11 June, that they would intensify the squeeze resulting from our earlier decisions on cash limits.

The problem is common to all departments where a significant proportion of expenditure attracts VAT or petroleum duty. There is no way round it within the policies which we have collectively adopted and announced. So, while I should welcome the first part of the reply to critics which you propose and the economy efforts to which you helpfully refer, I see considerable difficulties in the last sentence of your paragraph 3, which would suggest that if during the year it becomes clear that further funds are needed, then the Government would seek Parliamentary approval accordingly.

The Government have announced the collective decision to maintain and enforce the cash limits: and for the effective control of public expenditure, and the budgetary and tax strategy which depend on it, it is essential that we do in fact enforce them.

I would see no difficulty in your taking the public line that the £100 million, and our decision to increase defence cash limits by the full cost (£269 million) of the forces pay award, demonstrate

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the high priority we attach to defence. But that I think is as far as one can go. Now to imply that we have also taken a decision in principle to relax some of the major cash limits if in the event they prove uncomfortably constricting would overturn our earlier announcements both in presentational credibility and in substance. I must ask you to stick to the understandings in your minute of 30 May to the Prime Minister and my letter of 5 June.

I am sending a copy of this letter to the Prime Minister and other members of OD, the Lord President, and Sir John Hunt.



John Biffen

JOHN BIFFEN

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26 JUN 1979



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Defence

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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MO 8/2/12

*1. Mr. Latham
2. P.A.
JL*

CHANCELLOR OF THE EXCHEQUER

THE FINANCIAL PROSPECT 1979-80

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The increases in Value Added Tax and petroleum duty in the Budget will cost the Ministry of Defence about £200m in the current financial year. I am anxious that the Ministry of Defence should work within the same cash limits discipline as all other Departments. As you will have seen from my minute of 4th June to the Prime Minister, I have in hand a number of studies designed to produce savings and streamlined administration, as well as absorbing the 3% cut on civilian staff expenditure.

2. I shall therefore do my best to absorb as much of this extra £200m as I can. But I am conscious that I may be vulnerable in Parliament and in NATO to the critics who will argue that our extra £100m to maintain the equipment programme has been more than offset by the tax increases, with the result that in real terms our planned level of expenditure is even lower than that of our predecessors.

3. We should clearly need to scotch any suggestion of this kind. I would propose to deal with any such criticism by saying that the Ministry of Defence was playing its full part in the containment of public expenditure and the maintenance of the cash limits discipline, but that as we have already emphasised we are determined to maintain the provision of essential defence resources; and that if it becomes clear during the course of the financial year that further funds are needed then the Government would seek Parliamentary approval accordingly.

*The Chancellor
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possibly
accept
this!
JL*

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4. Such a reply would underline our commitment to discipline and economy. At the same time it would make clear that we intended to maintain the decision we have taken to remedy the underfunding of the programme that we inherited from our predecessors.

5. I hope that you will agree to this course of action and that you will be content for me to speak in this way if I am pressed on this point.

6. I am sending a copy of this minute to the Prime Minister, our OD colleagues, the Lord President and Sir John Hunt.

A handwritten signature in dark ink, appearing to be 'J. H.', with a horizontal line underneath.

20th June 1979

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20 JUN 1979





10 DOWNING STREET

THE PRIME MINISTER

5 June 1979

*Original
in GTR
Defence*

Dear Mr. Wellbeloved

Thank you for your letter of 25 May about air defence fighter aircraft.

I am surprised by your suggestion that I had "cast doubt on the prospect of carrying through the proposal to substantially increase the number" of such fighters. As I said in the House, this "proposal" was not a substantive decision taken by the Government; it was no more than a decision in principle taken by the Air Force Board, without any allocation of money for the additional aircraft.

The conclusion which the Air Force Board reached was only the first step in a very long process which all major defence projects must go through. As you well know, the Air Staff then have to carry out detailed studies of available options, and this they are now doing. Even when the Air Force Department have considered the results of such studies, further consultations both with others concerned within the Ministry of Defence and with other Government Departments are needed before the views of Ministers collectively are sought. For you to give the impression that a firm decision had been reached by the previous Government is to say the least disingenuous.

I am also surprised by your suggestion that we should publish "the basis upon which the meeting at the Ministry of Defence reached the conclusion that UK air defence was a matter of high priority". I understand that the paper which was discussed by the Air Force Board, and the minutes of the Board meeting, were classified as SECRET, so that there can be no question of

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publishing them. Moreover, you will be aware of the convention whereby Ministers of an incoming Administration do not have access to papers of the previous Government, so that it would not be appropriate for us to see those documents. However, we have, of course, been very fully briefed on the defence programme.

The failure to provide proper home-based air defence is only one of the weak points we have inherited, and we have already given practical proof that we intend to improve our national security.

Yours sincerely

MT

James Wellbeloved, Esq., M.P.

MANAGEMENT IN CONFIDENCE



ROUT
MACH NEG

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000
DIRECT DIALLING 01-218 2111/3

MANAGEMENT IN CONFIDENCE

TOP COPY ON: QUANGOS,
MAY 79,
GOVT. MARCH.

MO 8/14

PRIME MINISTER

THE SEARCH FOR ECONOMY

Present Background

The Ministry of Defence is concerned to ensure that resources allocated to defence are concentrated on essential defence needs and not dissipated in excessive administration or unnecessary frills. The decisions of our predecessors compelled this approach and I am re-emphasising it now.

2. Even before the unified Ministry of Defence was set up in 1964, certain functions of the Service Ministries had been rationalised, eg much of their purchasing under the Ministry of Supply, and their works departments into the Ministry of Public Building and Works (now the Property Services Agency). Since unification the search for economy has continued. Rationalisation both within and between the single Services, so far as it is compatible with essential operational control, has been pursued as a matter of deliberate policy in the supply and logistics area; for example the supply of nearly 25% of the three million items in MOD stocks is managed by a single Service on behalf of all three (many of the remaining items being unique to single Services). Examples include motor vehicles and spares, food, accommodation stores, aviation fuel, medical spares, and clothing.

3. I believe you will wish to know the scale of recent cut-backs. Eighty Army establishments have been closed, and the number of active RAF stations in the United Kingdom reduced by over 40% from 166 to 97. 82,000 acres of land have been disposed of. By the end of this year eight Fleet Support Establishments will have been closed since 1974. The Command structures of all three Services have been streamlined with large reductions in their staffs.

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Our R&D establishments have been reduced from 25 to 12. Accounting systems and internal audit arrangements have been centralised. In a number of areas, such as statistics, contracts, management services, and Defence Police, separate staffs have been brought together into a single organisational unit. Military and civilian staff in MOD headquarters have been cut by 13% and 14% respectively since 1973/74. Senior staffs (Under-Secretary and the Service equivalent and above) have not been neglected - they are down by 9%. Considerable savings have also been made in general administrative expenditure in areas such as travel, communications, printing and stationery (a real reduction of well over one-third).

External Constraints

4. There are a number of external factors and pressures, some of them inescapable, which militate against the search for economy. There are increasing demands to provide financial information to the Treasury and to Parliament, and the staff effort involved is compounded by the compressed time-scale within which the figures often have to be produced. Other demands on staff have arisen or are likely to arise from the requirements of the Health and Safety legislation and from any public right of access to official information. Thirdly, since money unspent at the end of the year has to be surrendered and cannot be recovered, there is a natural tendency to bring expenditure forward when potential underspending - frequently caused by unexpected manufacturing delays - is identified. A financial system which recognised that management is a continuous process would avoid the kind of pressure that leads to the inclusion of second priority items to mop up underspending. Some ideas in this area have already been given to Sir Derek Rayner. Fourthly, the dispersal programme would add a significant extra manpower bill in both the short and longer term, as well as extra support costs. I have already set in hand a new assessment of this.

Further Measures

5. Notwithstanding all this I have begun already to intensify efforts in the search for economy in these areas, but in addition I propose to arrange for:

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3.

- a. The Minister of State to lead an initial investigation into our procurement processes (from the stating of the requirement to delivery) - this is a major task and one where we must always be concerned to secure value for money and continued cost consciousness;
- b. The three Parliamentary Secretaries each to lead studies of activities within the three Services and in three particular areas - the use of energy in all its forms; movements (where we spend about £180M a year); and the defence estate;
- c. A review of all committees;
- d. The collection of suggestions from the staff - military and civil - for cutting waste. I should want to offer a limited number of financial prizes to give some extra incentive.

I should be glad for Sir Derek Rayner, who has already had a talk with my Permanent Secretary, to be associated with these activities if he wishes.

6. We agreed in Cabinet to have a special look at QUANGOs; but the involvement of the Ministry of Defence with bodies of this kind is so small (£16,000 a year in total cost) that I do not think that a detailed examination would produce any worthwhile results.

7. I make these suggestions quite separately from my consideration of the Lord President's proposals for savings in Civil Service numbers, on which I have written to you already to the effect that I shall be looking positively at the scope for further savings.

8. I am copying this minute to the Chancellor of the Exchequer, the Lord President, and Sir John Hunt.

4th June 1979

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Defence ^{tw}

10 DOWNING STREET

From the Private Secretary

14 May 1979

The Defence Budget and Cash Limit

The Prime Minister has seen the Defence Secretary's minute (MO 25/2/88/1) of 10 May about the re-affirmation, in the draft NATO Ministerial Guidance, of the aim for a 3% a year real growth in defence spending.

The Prime Minister agrees with Mr. Pym's recommendation that he should give strong support to the proposed renewal of the call for a 3% a year real increase in defence spending for the years up to 1986. The Prime Minister has seen and taken note of the Chief Secretary's comments in his minute of 11 May: she would not, however, wish Mr. Pym to qualify his support for the 3% increase in terms such as those set out in paragraph 4 of Mr. Biffen's minute. The Prime Minister takes the view that to make this kind of qualification would be tantamount to giving no undertaking at all. The Prime Minister recalls that the terms of the Ministerial Guidance already make some reference to the economic circumstances of member governments which should adequately meet the Chief Secretary's point.

I am sending copies of this letter to Paul Lever (Foreign and Commonwealth Office), Alistair Pirie (Chief Secretary's Office) and Martin Vile (Cabinet Office).

B. G. CARTLEDGE

J.D. Gutteridge, Esq.,
Ministry of Defence.

ABD

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Ref A09546

PRIME MINISTER

[Now received flag A]

Prime Minister

The Chief Secretary's letter has not yet arrived, but do you agree with para. 4 of this minute? If so, I shall act as suggested.

But 11/5

DEFENCE BUDGET AND CASH LIMIT

1. The Secretary of State for Defence has to attend the NATO Council meeting in Brussels next week, at which he wants to reaffirm the United Kingdom commitment to the 3 per cent growth target in national defence budgets. The timing of this Council is unfortunate. It means that he has to enter into this commitment before Ministers have had a chance to look at the forthcoming public expenditure survey. It would of course have been possible for him to plead that the new Government had not yet had time to consider its policy on this. But understandably he wants to be as forthcoming as possible.

2. However, there is a serious risk that in so doing, he will unilaterally pre-empt the claims of a number of other spending Ministers for exemption from the forthcoming public expenditure cuts. The Manifesto is quite clear that the Defence budget must be given priority, but the extent of that priority is still to be considered.

3. The Treasury is understandably worried about this. I believe the Chief Secretary is on the point of writing, to say that he is content with the line proposed, "provided it is understood that our room for manoeuvre in the public expenditure survey must not be prejudiced, and that the wording is not binding and allows for such exceptions as national economic circumstances may require." The text of the draft guidance is in fact in terms which allow this proviso to be met.

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in least amount to making no understanding of any kind. The

3/2 Commitment if I remember correctly was always subject to economic circumstances

4. I think you may wish to lend support to the Chief Secretary's reservation, saying that while of course defence must have top priority, we must not enter into any precise or irreversible commitment at this stage, until the Public Expenditure Survey as a whole has been studied by Ministers. Since the Secretary of State leaves for Brussels on Monday, it would be desirable that this message should, if you agree with it, go out as early as possible.

See memo on

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John

JOHN HUNT

11 May 1979



PRIME MINISTER

THE DEFENCE BUDGET AND CASH LIMIT: NATO MEETING

I have seen the Defence Secretary's minute of 10 May about the NATO 3% target and the forthcoming meeting of NATO Defence Ministers.

2. We can only address the question of the appropriate level of UK Defence Expenditure in the years after 1980-81 in the context of our forthcoming consideration of future public expenditure as a whole. We shall no doubt wish then to explore the implications which steady 3% annual increases in real terms would have for the share of national income allocated to defence, and our plans to reduce public expenditure.
3. If he felt that next week's discussion in NATO might in any way pre-empt our consideration of these questions I would wish the Defence Secretary to strike a note of caution. I am sure that his NATO colleagues would understand that, one week after taking office, we are not in a position to enter into commitments about the precise levels of particular programmes some years ahead.
4. Provided that it is understood that our room for manoeuvre in the public expenditure survey must not be prejudiced, and that the wording is not binding and allows for such exceptions as national economic circumstances may require, I am content that he should subscribe to the "Ministerial Guidance" document, thereby reaffirming our support for 3% increases as a desirable aim.
5. I am sending copies of this minute to the Foreign and Commonwealth Secretary, the Defence Secretary, and Sir John Hunt.

W.J.B.

JOHN BIFFEN
11th May 1979

11 MAY 1959



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MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

TELEPHONE 01-218 9000

DIRECT DIALING 01-218 2111/3

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MO 25/2/88/1

PRIME MINISTER

Prime Minister

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on view of the situation
and the financial state
See page 13
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THE DEFENCE BUDGET AND CASH LIMIT

The draft Queen's Speech which we are now considering reaffirms our commitment to improve the security of the nation and strengthen our contribution to NATO. We have always recognised that this will cost money.

2. I shall be in Brussels next week for a meeting of NATO Defence Ministers to discuss among other things the draft Ministerial Guidance for 1979. This is a document which provides broad strategic and political guidance for the Alliance as a whole, including the question of resources for defence. The latest version will cover the period up to 1986. Decisions on it cannot be deferred, since it is a key part of the two-year planning cycle.

3. On resources, the 1977 Guidance called on member countries to aim at an annual increase of 3% in real terms up to 1984. Our predecessors subscribed to this (as did other members of the Alliance), and their last White Paper on public expenditure showed 3% year-on-year real increases in the defence budget in 1979-80 and 1980-81, but not beyond. The White Paper stated that no decision had been taken about the defence budget for subsequent years.

4. The draft of the new Ministerial Guidance from NATO proposes reaffirming the aim of 3% a year real growth, rolled forward to

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1986. In my view we must support this. Believing as we do that this country, and the West as a whole, need to increase their defence effort, we should play our part in setting the Alliance a challenging target from which back-sliding is difficult. I regard it as unthinkable that we should open our account in NATO by stepping back from something which our predecessors signed on for last time round.

x || 5. Subject to your agreement, therefore, I propose to give strong support to the proposed renewal of the call for 3% a year real increases in defence spending by NATO members, for the years to 1986. This will not constitute a formal commitment, by us or any other Alliance member. But we must recognise that it will intensify expectations that the United Kingdom will come through with 3% for the years after 1980/81. There is a compelling case for this in the interest of our security, and I shall be proposing in our forthcoming PESC discussions that we should decide accordingly.

6. I am sending copies of this note to the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer, and to Sir John Hunt.

10th May 1979

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10 MAY 1979



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