

The Defence Budget.
 Defence Expenditure 1980-81: Contracts
 Moratorium.

PART 4

DEFENCE

The arming of service women.

United Kingdom MILITARY Training
 Assistance SCHEME [UKMTAS] [Table of UK Arms
 Sales]

Part 1 : May 1977

Part 4 : October 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
3.11.80		6.3.81					
11.11.80							
14.11.80							
17.11.80		- ends -					
18.11.80							
26.11.80							
3.12.80							
12.12.80							
23.12.80							
13.1.81							
22.1.81							
2.2.81							
4.2.81							
11.2.81							
16.2.81							
24.2.81							
26.2.81							
5.3.81							

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PART

4

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PART

5

begins:-

11. 3. 81

Defence



PRIME MINISTER

*Raised at meeting
for
Amth - 6/3*

STATEMENT ON THE DEFENCE ESTIMATES

It was resolved at OD yesterday that the Defence White Paper should include a reference to the problems of reconciling commitments and resources.

I feel there is more danger in not rehearsing the arguments than in overplaying this problem. The Secretary of State for Defence has underlined that current economies are undermining the operating efficiency of the armed forces. This will sustain the growing feeling that we are overstretched in our defence capability, and the Trident nuclear option will be seen as a further weakening of the resources that might be available for conventional defence. In such circumstances anti-nuclear sentiment will go much wider than in the 1950s, and in circumstances that could be electorally harmful.

The best way to prevent or limit this danger would be to have a clear undertaking to order and balance our commitments within the resources we choose to make available for defence, and to be seen to be doing just that.

I am copying this minute to other members of OD and to Sir Robert Armstrong.

W. J. B.

Department of Trade
1 Victoria Street
London, SW1H 0ET

JB

6. March 1981

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: OD(81) 4th Meeting, Minutes

Date: 5 March 1981

Signed Wayland Date 26 July 2011

PREM Records Team



Defence

MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1
 Telephone 01-~~2307232~~ 218 2111/3

MO 21/2/26

5th March 1981

Dear John,

2 03

STATEMENT ON DEFENCE ESTIMATES 1981

see folder attached

I understand that it was agreed at OD this morning, when the Committee discussed my Secretary of State's Note OD(81)13, that any detailed drafting points on the draft Statement that Ministers wished to make should be put to us not later than 12th March.

I should be very grateful if these points could be put to me by Private Secretaries, or to Mr R T Jackling, Head of Defence Secretariat 11 (telephone number 218 3287, Room No 9328, Main Building) by officials by not later than noon on that day. After that time we will assume that no points remain to be made. If comments can come earlier than 12th March that would be very welcome.

I am sending copies of this letter to the Private Secretaries to the other members of OD; Ian Ellison in the Department of Industry; and Michael Alexander (No 10) and David Wright (Cabinet Office).

*Yours and
 Brian*

(B M NORBURY)

J F Halliday Esq

Also copied
to Defence, Oct 79
future use
Defence Policy

Ref. A04369

PRIME MINISTER

Statement on the Defence Estimates 1981

(OD(81) 13)

BACKGROUND

OD discussed the 1980 Defence White Paper on 22 January last year, and subsequently had two major discussions on defence policy on 20 March and on 8 July. On 20 March the Committee were left with the impression that there was a need to reshape the defence programme in fundamental terms to fit the resources available; but when the then Secretary of State for Defence put forward his proposals for discussion in July they were less radical than expected earlier. In OD(81) 13 the Secretary of State for Defence now warns his colleagues that the need for a fundamental review to match defence commitments with the available resources still exists, and that he expects to reach conclusions in the summer. Thus the present situation is similar to that which prevailed following the OD discussion last March.

2. The Secretary of State for Defence proposes with the agreement of OD and Cabinet to publish the 1981 Statement on the Defence Estimates (SDE) about 13-15 April. This proposal should not give rise to any difficulties in relation to the Public Expenditure timetable.

3. On the form and substance of the SDE there is one important innovation this year. It follows the usual form of a statement of policy in Chapter 1, followed by an account of current activity in various defence fields in the subsequent chapters. But between the various chapters are a number of free-standing essays on the underlying considerations which have to be continuously taken into account in making and implementing policy in the defence field (the pages concerned have, in the present typescript, a "frame" round them). The Secretary of State for Defence inherited this format from his predecessor. He is likely to seek the views of the Committee on whether it commands general approval.

4. The special emphasis given during your Washington visit to the enhancement of our military capability in the Gulf region will need to be echoed in the final version of the SDE.

5. On a point of detail last year's SDE cost £4.50 for Vol 1 and £4.00 for Vol 2 from Her Majesty's Stationery Office. This year the two volumes are likely to cost over £10.00 even though it costs less than £1.00 to produce Vol 2. The SDE is one of HMSO's best sellers each year and most copies go to official purchasers.

6. The Secretary of State for Industry has been invited for this discussion because of the industrial implications of the defence programme. The Chief Secretary has also been invited because of the Public Expenditure implications. The Secretary of State for Defence has not asked if he might bring the Chief of the Defence Staff or other Chiefs of Staff; they did not attend with Mr Pym this time last year.

HANDLING

7. The Secretary of State for Defence should introduce his covering papers and the draft SDE. Quite a number of points arise on it. Some of them could suitably be dealt with in correspondence. Those in the Annex to this brief could, if you agree, form the basis of a letter which Mr Alexander could send to the Private Secretaries concerned after OD has met. That would leave you free to concentrate OD's discussion on the following major issues (or on a selection of them, leaving the others to be included in Mr Alexander's letter):-

- (a) What do the Foreign and Commonwealth Secretary and Chancellor of the Exchequer think of the idea in the last sentence of paragraph 3 of Mr Nott's covering paper that the SDE should include a very short introduction referring in guarded terms to the need for a further review of defence commitments over the next few months? The Chancellor of the Exchequer is likely to be in favour of such a statement. How does the Foreign and Commonwealth Secretary feel that it might affect our allies, particularly the United States? What are the risks of appearing disingenuous later if we were to say nothing now?

- (b) Defence Policy in a Changing World (Chapter 1 of the draft SDE).
Is anything in Chapter 1 affected by the outcome of your discussions in Washington? Is it sensible in line 2 of paragraph 111 to refer to the vast resources of the United States in comparison with its individual allies? The United States tend to make the comparison with their European allies collectively, and on that basis the disparity is far less marked.
- (c) "Britain within NATO" (free standing essay following para 126).
Do the Secretary of State for Defence and Foreign and Commonwealth Secretary feel it is right for paragraph 7 of this essay to continue to refer to the desirability of a new review effort by the Alliance in the light of the cool American reaction to this idea? Does this essay as a whole make a useful contribution to the value of the SDE?
- (d) Theatre Nuclear Force Modernisation (paragraphs 215-223).
- (1) Ought consideration to be given to providing the Tornado with in-flight refuelling facilities and tanker aircraft to give it a range equivalent to the Vulcans? Otherwise it will scarcely be able to reach the Soviet Union from United Kingdom bases.
 - (2) Paragraph 218 states that the long-standing arrangements for consultation about the use of United States nuclear weapons from United Kingdom bases would apply to United States-armed GLCMs based in the United Kingdom. There is no policy problem about this: it was specifically agreed in Washington last week. But we must consult the United States Administration in advance if this statement is to be made public in the SDE. I have this in hand through the channels established in Washington last week. If we consult the United States Administration (as we must) about this, should they see in advance the whole of the section on nuclear weapons? The Foreign and Commonwealth Secretary may have views.



- (3) The beginning of paragraph 219 says that there have been test firings of Tomahawk from a variety of launch platforms. Can the Secretary of State for Defence say whether these include submerged ones? If the answer is No the point should be made clear; and if the answer is Yes the whole sentence might be better omitted. We do not want to give unnecessary ammunition to those who argue that sea-launched Cruise Missiles would have been a better Strategic Deterrent choice for Britain than Trident. Our answer has always been that they would in fact be "United Kingdom unique" and therefore more expensive, since the Americans were not developing the weapon for use from submarines.
- (e) BAOR's Reinforcement Plan (paragraphs 322-323).
Although the reinforcement plan has been worked out in great detail and practised to some extent in peacetime, does the Home Secretary believe that it is likely to work in a real emergency in the absence of parallel civil home defence planning and preparation? Would it really be possible to call up and despatch the reservists and TA units to Germany in those circumstances?
- (f) Royal Naval Deployments (paragraphs 412-414).
Are the Foreign and Commonwealth Secretary and Secretary of State for Defence satisfied with the arrangements that have been made for a British Naval presence in the Arabian Sea? The initial discussions with the United States Navy and the French did not seem to run very smoothly and the United Kingdom does not appear to have extracted the full credit deserved from the arrangements.
- (g) Enhancement of United Kingdom Military Capability Outside the NATO Area (paragraph 416).
OD took note of the measures proposed for such enhancement at at their meeting on 8 July. The reason why some of the

proposals are now contained in a square bracket in paragraph 416 is apparently that the Chiefs of Staff still have doubts about the priority to be accorded to them. If you yourself and the Foreign and Commonwealth Secretary feel that a high priority should be given to such measures, because of the political importance attached to them particularly in regard to the Americans, you may wish to invite the Secretary of State for Defence not merely to remove the square brackets but to add emphasis to this particular section of the SDE.

- (h) Defence Procurement Strategy (free standing essay following paragraph 526).

Does the Secretary of State for Industry have any general views on this essay and on the particular point in paragraph 5 about the size of the premium which ought to be paid for a "made in Britain label"? Do the Secretary of State for Defence and Foreign and Commonwealth Secretary have any different views on the desirability of new collaborative projects (paragraph 6) in the light of the overseas sales difficulties which have now been encountered with the West Germans over Tornado?

- (i) Harrier and Jaguar Replacements (paragraphs 617b and c).

These are likely to be among the biggest defence equipment decisions which the Government will soon have to take. The previous Secretary of State for Defence told OD, in his paper on the defence programme of 3 July last year, that recommendations would be coming forward shortly. When will the Secretary of State for Defence be making proposals? What is the financial scale of the problem? Has the Secretary of State for Industry any comments on its importance for British industry, particularly British Aerospace?

- (j) Civilian Numbers (paragraphs 732-742).

Is the Lord President satisfied that a reduction of civilian numbers in the Ministry of Defence is consistent with the Government's policy to increase its defence efforts, in view of

the fact that many Ministry of Defence civilians are doing the same job as servicemen? You may like to note with approval the point in paragraph 742 that the Ministry of Defence has more apprentices under training than any other single employer in Britain.

(k) The Defence Budget (Chapter 8).

Is the Chancellor of the Exchequer satisfied with these paragraphs on the financial aspects of defence? (The Treasury has been fully consulted in their preparation). Is it right to gloss over the probable difficulties which are likely to arise from a cash limits overspend in the current financial year?

CONCLUSION

8. The Committee might be guided to the conclusion that the Secretary of State for Defence should be invited:

- (i) to circulate the draft Statement on the Defence Estimates 1981, amended as necessary in the light of discussion, for consideration by Cabinet on 19 March;
- (ii) to include a very short introduction referring to the need to study alternative deployments and operational concepts to match the available resources;
- (iii) to report back to the Committee when the studies give rise to new proposals.

REA

ROBERT ARMSTRONG

4 March 1981

Supplementary Points

The following points could be raised in correspondence, after OD has met, between the Private Secretary at No 10 and the Private Secretaries of Ministers directly concerned, viz the Secretary of State for Defence, Foreign and Commonwealth Secretary, Secretary of State for Northern Ireland (who will not have been at OD) and Home Secretary:

- (i) Arms Control (paragraphs 119-126 of SDE). Is the Foreign and Commonwealth Secretary content with these paragraphs. Or does their reference to the active participation of the United Kingdom in the negotiations on Mutual and Balanced Force Reductions and on a Comprehensive Nuclear Test Ban Treaty sound rather exaggerated given that on both subjects very little progress has actually been made.
- (ii) "Nuclear Weapons" (free standing essay before paragraph 201). This usefully provides an authoritative source of material for countering CND propaganda.
- (iii) Trident (paragraphs 206-213). When will a decision have to be taken on the option of building a fifth boat? Does the Government also need to keep open the option of buying D5 instead of C4 missiles, in case the United States Government introduce the D5 missile to their own service earlier than anticipated. Is it proposed to build Polaris replacement boats with Ohio (ie fatter) mid-sections in order to keep open the D5 option? How would this affect the total costing of the programme?
- (iv) Chevaline (paragraph 214). In the light of the most recent flight trials, is there any certainty about the date when Chevaline will enter service?
- (v) NATO Strategy (paragraph 307). When OD discussed the SDE 1980 in January last year attention was drawn to the imprecision

of the phrases "flexible response" and "forward defence". Do the conventional forces now available to SACEUR give a reality to the phrase "flexible response", or do they merely represent a slightly delayed tripwire?

- (vi) Warsaw Pact Forces in the Central Region (paragraph 316).
What new assessment of the Warsaw Pact forces in the central region has NATO made in the light of the current situation in Poland? It seems possible that the Polish divisions may now be a liability rather than an asset to the Warsaw Pact, requiring shadowing by Soviet divisions.
- (vii) Air Defence of the United Kingdom (paragraphs 335-337). Is an adequate number of aircraft available in the first line of air defence described in paragraph 336? If not, what priority is being given to increase their number?
- (viii) Merger of 41 Commando Royal Marines (paragraph 347). Has the merger of this Royal Marine Commando, which was announced on 20 January, caused any particular stir either in this country or with our NATO allies?
- (ix) "Low Flying" (free standing essay before paragraph 401). Is this in the right place in the SDE? And should it be included at all? Low flying is an irritant, eg to farmers. Will this essay do anything to improve the situation?
- (x) Northern Ireland (paragraphs 503-506). Is it expected that there will be further withdrawals of units on emergency tours in the Province? Is there real military justification for isolated units which have to be supplied by helicopter and may be resented by the local population, eg in places like Crossmaglen? Should OD give further thought later in the year to the prospects for getting all troops off the streets in Northern Ireland?
- (xi) Princes Gate Siege (paragraph 508). Is the Home Secretary satisfied with this account of the Princes Gate siege? Is it accurate? Ought not "shortly afterwards" in line 12 to be "subsequently"? The interval between shots being heard and

the dead hostage being dumped on the doorstep was surely about 5 hours (1 pm to 6 pm).

- (xii) Main Battle Tank (paragraph 616a). Will the half-fleet of Chieftain tanks which will remain in BAOR have the guns and armour to match the Soviet threat? If so, why is the other half-fleet going to be replaced with Challenger? If not, why is the whole fleet not being replaced?
- (xiii) Chemical Warfare (paragraph 616h). Is there any real protection against chemical warfare except the possession of an offensive capability? Is there any suggestion that the United Kingdom should acquire such a capability?
- (xiv) Naval Programme (paragraph 619). To what extent is the nuclear powered fleet submarine programme likely to be affected by the Polaris replacement programme? Is Vickers going to remain the only nuclear yard? Are Invincible and her two sister ships going to be purely anti-submarine carriers? Will they not also have a useful intervention capability outside the NATO area which might be advertised? In the light of our experience with Sting Ray, will it really be sensible to seek to develop a new British heavyweight torpedo rather than buy from the Americans something which they are going to develop anyhow?
- (xv) Defence Sales, Operational Analysis, Royal Ordnance Factories Royal Dockyards, Electronic Warfare and Research (series of free standing essays following paragraph 627). Is the format right? Whereas most of the essays in the SDE are designed statements of general policy, some of these seem more in the nature of reports on work in progress. Some of these subjects appear to lend themselves to the latter treatment. On points of detail, is there anything to report on the future of the Royal Ordnance Factories? In regard to the Royal Dockyard, the situation set out in the table 3.7 shows a halving in the number of major refits and normal refits completed in the period

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- 1975-76 up to 1979-80 with a labour force in the dockyard which is only slightly reduced. Is that acceptable?
- (xvi) Servicemen and Women (paragraphs 701-711). Are there any plans for cutting the numerical requirement for servicemen in view of the fact that demographic trends are likely to make recruiting more difficult in the future? (Paragraph 708).
- (xvii) The Womens' Services (paragraphs 722-724). In view of the emphasis placed on the increased use of women in the armed forces (paragraph 722), why does the table at 4.2, which gives strengths of trained United Kingdom Service personnel in the regular forces, show an anticipated reduction in numbers of Service women in 1982? Has the proposal to arm women now gained general acceptance?
- (xviii) Defence Statistical Services (paragraph 820e). This paragraph recommends a 15 per cent reduction in the amount of data currently collected, as an administrative economy. If economy is an aim in this field, is the size of volume 2 of the SDE really justified? Are all these various statistics genuinely required for management purposes or are some of them being produced from force of habit?
- (xix) The Defence Estate (paragraph 821). It is an important element in the Government's policy that surplus and under utilised public sector property should be disposed of wherever possible. What progress has been made as regards the Defence Estate?
- (xx) Last year's SDE cost £8.50. This year's will no doubt be more than that. Is it wise to insist on a price which virtually places it beyond the reach of the private purchaser?

4th March 1981



David Young
Special Adviser

Defence

Department of Industry
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123 Victoria Street
London SW1E 6RB

Telephone: Direct Line 01-212 0440
Switchboard 01-212 7676

3rd March, 1981

T. P. Lankester, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

R 4/3

Dear Mr Lankester

DISPOSAL OF SURPLUS DEFENCE LANDS

Further to Mr. Young's letter of 12th February, he thought you might be interested to see the attached copy of a letter from MoD (replying to my enquiry) confirming slow, but hopefully sure, progress.

Yours sincerely

Miss Lambert

Miss G. M. A. Lambert



DUS(PL) 78/81
1/51/25/2

MINISTRY OF DEFENCE

Main Building, Whitehall, London SW1A 2HB

Telephone (Direct Dialling) 01-218 7152

(Switchboard) 01-218 9000

From: A R M Jaffray, CB, Deputy Under Secretary of State (Personnel and Logistics)

Miss G.M.A. Lambert,
Department of Industry,
Ashdown House.

PL
24/3
27 February 1981

Dear Miss Lambert,

DISPOSAL OF SURPLUS DEFENCE LANDS

Thank you for your note of 25 February.

2. The position is that we have provisionally identified for the PSA sixteen possible sales with a combined sale value of about £15m. The next steps are for:-
 - a. the MOD to confirm finally that there are no policy or planning considerations that might stand in the way of any of these sales;
 - b. the PSA to consider which of them are suitable for offering under arrangements of the kind we envisage, and what sort of conditions of sale would be appropriate;
 - c. the Treasury to consider whether there are any general financial or accounting principles which need to be taken into account by Ministers before we finally commit ourselves to these arrangements.
3. I hope that we will be able to bring these three strands together in the latter part of next month; and I think the next meeting with Mr. Young could most usefully take place then. For the present, we are on course and I doubt if there is much that we could usefully discuss with him before this further work has been done.
4. As regards Little Rissington airfield, I can confirm that we have offered it to the Americans and they wish to take our offer up.
5. I am copying this to John Delafons in the PSA.

Yours sincerely

Alan Jaffray



COMMERCIAL IN CONFIDENCE

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/11005/81

Your ref:

26 February 1981

See file

DEFENCE PROPERTY DISPOSALS

Thank you for your letter of 2 February about testing the idea that PSA should act for you in selling and leasing back Defence property which you think is likely to become surplus in a few years' time.

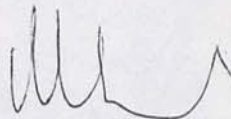
We will gladly undertake this work for you but it is likely to involve us, and the Treasury Solicitor, in a substantial amount of work. We will have to ensure that it does not divert resources from the normal disposals work which PSA handle and which is running at a high rate. We shall have to rely heavily on your co-operation in the early identification of suitable properties if we are to stand any chance of getting the money in by the end of the second quarter of 1981/82. This will be a novel venture not only for us but also for potential purchasers. We must recognise that the first few schemes are likely to throw up difficulties and problems which may delay them for longer than those which follow on later.

My officials have had discussions with the Treasury Solicitor who will handle the pre-sale legal documentation and the post-sale conveyancing. Together, they consider it will take not less than 6 months from the time you notify us of suitable properties until we actually get money in. This will be taken up in pre-sale documentation (about 8 weeks), offer and acceptance (about 10 weeks), and conveyancing (about 8 weeks). To give us time to prepare the tender documents and invite bids by not later than 1 May, we should need to have suitable schemes identified by the end of this month. You will need to let us know definitely by the end of March at the latest if you are to stand any chance of taking advantage of the proceeds in 1981/82. But any delay in receipts will accrue to the benefit of later years.

It will be important that we try and market the most saleable propositions first. Whilst I recognise that it will be for my officials, with David Young's help, to recommend the sort of terms on which the properties might best be offered to the institutions, they will look to your people for precise instructions about what can and cannot be sold.

I agree that our officials should report to us jointly on the results of the work they now have in hand. The end of April will, however, be too late if you are to reap the benefit from sales in 1981/82. I leave it to you to decide whether you can bring that date forward.

I am also copying this letter to the Prime Minister in view of earlier interest and to Geoffrey Howe, Sir Robert Armstrong and David Young.

yes sir


MICHAEL HESELTINE

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10 DOWNING STREET

From the Private Secretary

24 February 1981

Defence Representation Overseas: Economies

The Prime Minister has seen the Defence Secretary's minute to her of 20 February about reductions in defence representation overseas. She has commented: "excellent".

I am sending copies of this letter to the Private Secretaries to the members of OD and to David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

B.M. Norbury, Esq.,
Ministry of Defence.

SB



(2)

MO 1/16

Prime Minister
As far as Washington is concerned
this is long overdue.

Excellent
no. [Signature]

PRIME MINISTER

DEFENCE REPRESENTATION OVERSEAS:
ECONOMIES

I would like to report the outcome of the plan, consistent with the 10% reduction in overseas representation generally, to reduce defence representation in Washington and in the nine next largest of our overseas Missions.

2. In Washington I shall be making a reduction of 25%, including the abolition of the "3-star" (Deputy Secretary equivalent) post of Head of British Defence Staff. In future instead of 4 top military posts, one of them "3-star" there will be three posts, two "2-star" and one "1-star". Another Assistant Secretary level post will also be cut.
3. In the other nine Missions I will be making a reduction of 10% - cutting 10 posts, two of which are Full Service Attaches.
4. Reductions will have been completed by 1st April next year.
5. I am sending copies of this minute to the Foreign and Commonwealth Secretary and our other colleagues on OD; and to Sir Robert Armstrong.

JW.

Ministry of Defence

20th February 1981



David Young
Special Adviser

Defence

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16th February, 1981

T. P. Lankester, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

✓ LA An Watson

Dear Tim,

R

DISPOSAL OF SURPLUS DEFENCE LANDS

I wrote to you on 12th February about discussions I have been having with MOD and PSA officials on this subject. One matter that I omitted to deal with was the disused airfield at Little Rissington, near Burford, Oxfordshire.

MOD have confirmed that this is in fact disused but is being made available to the United States forces. I have asked for further details and will come back to you in due course.

*Yours ever
David*



David Young
Special Adviser

Defence

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12th February, 1981

T. P. Lankester, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

Dear Mr Lankester ^{TL} _{12/2}

DEFENCE PROPERTY SALES

I have seen a copy of John Nott's letter of 2nd February to Michael Heseltine on this subject.

As mentioned in this letter, since I last wrote to you on 16th January, I have had further discussions with MOD and PSA officials to pursue the possibility of accelerating sales. MOD have now undertaken to provide a list of possible candidates for sale and I am maintaining pressure on them to produce a worthwhile number. However, until I have seen the extent of such a list and also the type of properties it contains it is very difficult to make any assessment of the sums that might be realised.

I will keep in touch with any further developments.

Yours sincerely

David Young

pp David Young

C A Whitmore Esq



CABINET OFFICE

With the compliments of
The Private Secretary to the
Secretary of the Cabinet

70 Whitehall, London SW1A 2AS

Telephone 01-233 8319

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CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB CVO

Print
1. Mr. [unclear]
2. [unclear]
[unclear]
11:00

Ref. A04232

10 February 1981

Statement on Defence Estimates 1981

Thank you for your letter (MO 21/2/26) of 9 February about the timing of the publication of this year's Statement on the Defence Estimates. The Prime Minister's absence in Washington in the week of Monday 23 February means that we are not planning any meetings of OD that week. We will, however, suggest to the Prime Minister in our forthcoming proposals on business that there should be a meeting of OD in the week of 2 March when the Statement might be discussed. This should, as you suggest, permit the Statement to be considered in Cabinet on either 12 or 19 March; clearly since your Secretary of State should be present when the Cabinet takes the paper, this seems to point to 19 March.

In order to give Ministers plenty of time to consider the Statement, it would be welcome if the Memorandum could be circulated on or before 20 February.

Copies of this letter go to Clive Whitmore (No 10), the Private Secretaries to the Leader of the House and the Chief Whip, Robert Wade-Gery and Richard Hastie-Smith.

D. J. WRIGHT

(D J Wright)
Private Secretary

B M Norbury Esq

For Defence: Budget: P64

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Subject: Defence
filed on Defence: Oct 79
Future UK Defence Policy

NOTE FOR THE RECORD

The Secretary of State for Defence called on the Prime Minister on 10 February for a preliminary discussion of his ideas on future defence policy. The Foreign and Commonwealth Secretary was also present.

Mr. Nott said that he would not be announcing any new decisions before May or June. However, he wished to be certain that the ideas which he would be developing in the intervening weeks were not totally unacceptable to the Prime Minister and Lord Carrington. He also hoped to ensure that the line the Prime Minister took in Washington would be compatible with the emerging policy. *This does at this stage were essentially personal but he knows that his Senior Officials were thinking on similar lines.* The Defence Budget was hopelessly over-extended both in the short and in the long term. As regards the short term, there would be no way of squaring the circle if the Treasury were to insist on a £300 m claw-back. At least no way short of closing down the shipbuilding industry and reneging on a number of NATO commitments. Even leaving aside the £300 m, it was not at all clear where the other £150 m which would have to be found in 1981/82 would come from. The Prime Minister commented that she was appalled by the degree of over-commitment which had been allowed to arise. She was not impressed by Mr. Nott's argument that the Ministry of Defence had become used to under-spending, and had been caught out by the recession.

As regards the longer term, the long term costings, which would be coming to hand within a month or so, seemed likely to suggest that the Defence Budget was over-committed to the tune of between £2 and 3 b. Out-turn figures were always much lower than long term costings, but nonetheless the degree of the excess at present in prospect was worrying. The difficulty lay in the increasing real cost of sophisticated weapon systems. Even if we adhered to the NATO target of a 3% growth year on year, we would not come close to standing still in volume terms. The scope of procurement would have to be narrowed, and the quantities would have to be smaller.

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- 2 -

This would no doubt give rise to industrial problems which would require careful handling. Up-coming problems in this area, included the Jaguar replacement, the Sea King replacement, and ~~track~~Rapier. We would have to buy more from the United States - though only on the basis that they bought more from us.

We would have to give more emphasis to the overseas sales requirement generally while recognising that decisions taken now e.g., to move towards the procurement of simpler weapons systems, would show results only after several years.

Procurement cut-backs would not suffice to resolve the budgetary problems. "Something would have to give." The sensible thing to do would no doubt be to withdraw a division from BOAR. However, this was politically impossible. Forward defence was central to the Government's European policies. Nor could savings be found in the home base. Indeed, our effort here was totally inadequate, and would have to be increased. Greater emphasis would have, for instance, to be given to the territorial army. A start would be made with the recruitment of a thousand young men through the Youth Opportunities Programme. General Richards, who had been about to be appointed Defence Attache in Washington, would instead be appointed as an adviser on the mobilisation of reserves. There would be a great deal of emphasis on the PR aspects of the appointment.

As regards the RAF, there was no scope for savings. Indeed additional expenditure would probably be required.

The main area for savings would therefore have to be the Royal Navy. The Navy needed more submarines and more mine-sweepers but its present surface capability was excessive and extremely expensive. The procurement of through-deck cruisers ~~had~~ had, to take one example, been grossly extravagant. (Mr Healey, who had been responsible, now admitted as much.) The Navy's programme of refits was similarly

/extravagant

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extravagant. It should be slowed down. The numbers of destroyers and frigates should be steadily cut back.

It would serve to make a decision to reduce our naval effort in the long run more palatable to the Americans if in the short run, we were to offer to help the Americans with the rapid deployment force. The through-deck cruisers would be ideal in e.g. the Gulf. The offer to the Americans would have to be on the basis that another NATO ally, presumably the Germans, would fill the resulting gap in the North Atlantic. The Foreign Secretary welcomed the idea of supporting the rapid deployment force. The Americans had already made it clear that they were pleased by the French presence in the Gulf. President Giscard would no doubt try to get on close terms with President Reagan. We could not afford to be left in the cold.

Lord Carrington said that he agreed with Mr. Nott's general analysis. He thought that in the end we would have little choice but to cut the Navy although he thought that on objective grounds this was the wrong decision. However, it would be essential to carry NATO with us in any decisions that we made. The Defence Secretary asked whether this was an argument for reviving the idea of a review of the "Health of the Alliance". He himself doubted whether this was the best way to secure agreement to changes in our deployments. The Foreign Secretary and the Prime Minister agreed that a NATO review would never get off the ground. We should start instead by discussing the paper we had prepared last autumn with the Americans.

The Foreign Secretary said that NATO defence planning as a whole made little sense. On the one hand, they were preparing for a 4-day war. On the other hand, they were relying on reinforcements which would take a month to arrive. The Prime Minister and the Defence Secretary said that it was safe to assume that whatever one planned for, the reality would turn out differently. The Defence Secretary's own view was that

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any war would be a relatively long drawn out affair, and that reserves would be necessary.

In a brief discussion on the nuclear deterrent, the Foreign Secretary expressed the hope that the forthcoming debate in the House would not be confined to Trident, but would deal with our nuclear defence policy as a whole, including questions of arms control. The Defence Secretary confirmed that it was his intention to deal with all the issues. It was essential to do so since two-thirds of the Party and two-thirds of the Cabinet were opposed to the procurement of Trident. Even the Chiefs of Staff were not unanimous. He himself believed that the decision was right, but also believed that in the end we would have to acquire 5 submarines and spend £10 b rather than £5 b. The Foreign Secretary said that he also was in no doubt about the decision. Failure to acquire Trident would have left the French as the only nuclear power in Europe. This would be intolerable. The Prime Minister, the Foreign Secretary and the Defence Secretary all agreed on the need to couple arms control with deterrence. The Defence Secretary added that he hoped nothing would be said in Washington or elsewhere in the next few months to suggest that HMG was committed to the acquisition of ERW and/or chemical weapons. To do so would add greatly to the problems of justifying our nuclear defence policy. He was confident he could win the argument by the autumn. Thereafter the acquisition of ERW, which was almost certainly desirable on military grounds, could be reconsidered.

It was agreed that the Lord Privy Seal should wind up the debate in the House of Commons when it took place.

Ministerial Organisation in the Ministry of Defence

The Defence Secretary said that he would be approaching the Prime Minister in the summer to ask her to abolish single Service Ministers. He wished to move to a Ministerial organisation based on a Minister of State for Procurement, a Minister of State

/ for

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- 5 -

for the Armed Services, and two Parliamentary Under-Secretaries. He would also be seeking changes in personalities: at present he had the worst ^(best/worst) team in Whitehall.

The Defence Secretary said that he was resisting pressure from CDS to confirm his successor now, and to decide at the same time on the next generation of single Service Chiefs. He had not yet decided whether to build up the role of the CDS or to abolish the post. One or other course was necessary. The Prime Minister counselled the Defence Secretary against building up a rival to himself. The Defence Secretary commented that the abolition of the post of CDS would enable him to get rid of a lot of bureaucrats. The Prime Minister enquired about the attitude of The Queen. The Defence Secretary said that he was given to understand the the Palace would not create difficulties.

Paul

10 February, 1981.

CONFIDENTIAL

Defence



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-9307032 218 2111/3

MO 21/2/26

9th February 1981

1. *M. Alexander*
I have discussed this with
Diana Wright.
2. *P.A.*
MB
9ii

Dear David,

STATEMENT ON DEFENCE ESTIMATES 1981

We have been giving some consideration to the timing of the publication of this year's Statement on the Defence Estimates; and my Secretary of State has concluded that he should aim for publication round about the middle of April, probably in the week immediately before the Easter Recess.

Given the lead time for printing, this timing suggests to us that we should ask for OD consideration of a draft late in the week beginning 23rd February or early in the week beginning 2nd March (my Secretary of State having circulated a memorandum on, or just before, 20th February). Such timing should fit in with the Prime Minister's impending visit to Washington and should allow subsequent consideration by the Cabinet either in the week beginning 9th March (when my Secretary of State presently plans to be abroad) or, more conveniently from his point of view, in the week beginning 16th March. I thought that I should write to say that I hope we can work to this general timetable.

I am sending copies of this letter to Clive Whitmore at No 10; the Private Secretaries to the Leader of the House and Chief Whip; and to Richard Hastie-Smith in the Cabinet Office.

*Yours and
Bain*

(B M NORBURY)

D J Wright Esq

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file

cc: FCO
HMT
DT
CO

BK

10 DOWNING STREET

18

From the Principal Private Secretary

9 February 1981

Dear David,

Prime Minister's Visit to 22 SAS:
Training Facilities

Thank you for your letter of 6 February 1981 which I have shown to the Prime Minister.

She was very glad to learn that the discussions with British Airways about training facilities for the SAS on wide-bodied aircraft have gone so well and that arrangements have been made to the satisfaction of the SAS.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury) Stuart Hampson (Department of Trade) and David Wright (Cabinet Office).

Yours ever,

John Wiggins

D.B. Omand, Esq.,
Ministry of Defence

SECRET

BK



MO 25/3/4

SECRET

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~3307822~~ 218 2111/3

6th February 1981

Clive
Was there any things
etc that SAS
needed? If so,
we can sort that
out too.

Prime Minister.
← Satisfactory progress.

6.ii.81

L Noisy in.
ms
ms

Dear Clive,

PRIME MINISTER'S VISIT TO 22 SAS:
TRAINING FACILITIES

In your letter of 7th January you asked to know when the SAS had settled satisfactory arrangements with British Airways for training facilities on wide-bodied aircraft. Discussions with British Airways have gone well and I can report that they will be making aircraft available to the counter-terrorist team at Heathrow so that they can get to know the aircraft layout and can devise suitable means of entry. They have also offered to help to familiarise team members with arrival ramp procedures so that in the event of an incident they could look over the hijacked aircraft without drawing attention to themselves, and they have given us access to technical information about the aircraft themselves.

In addition British Airways are making available their staff training mock-ups of aircraft cabins and flight decks for training the SAS in passenger evacuation techniques, needed after an assault. This is all most satisfactory to the SAS and, I should mention that British Airways have agreed to provide this assistance without any charge.

Once the SAS have built up their skills and experience on these types of aircraft they will be giving thought to whether they could use a British Airways wide-bodied aircraft in a more extensive anti-hijacking exercise, at a secure military airfield. British Airways would like to help us in this way when we are ready, subject to the availability of an aircraft without undue penalty to the airline, and to satisfactory arrangements being worked out on costs.

I should add that my Secretary of State entirely accepts the force of the Prime Minister's observations, recorded in your

C A Whitmore Esq

SECRET

SECRET



letter, about sales related training charges. This is one aspect which the Minister of State, Lord Trenchard, is looking at urgently. Mr Nott will be minuting the Prime Minister shortly to report on the action in hand.

I am copying this letter to the recipients of yours.

*Yours ever,
David Omand*

(D B OMAND)



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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

MO 10

2nd February 1981

Dear Michael

Prime Minister.

*Your initiative looks like
being fruit.*

*HW
3ii*

DEFENCE PROPERTY DISPOSALS

At the suggestion of the Prime Minister, our officials have been talking to David Young about ways of accelerating estate disposals in order to benefit the defence budget. Following his meeting last week with MOD and PSA officials I think we are in a position to move forward. I wish us to test the idea that we can arrange deals with institutions to buy from us married quarters and other buildings which would have been likely to become surplus in a few years time and to lease them back to us for the remaining period they are required. These deals would be especially advantageous if they could be made to include the financing of works services on which ultimate disposal depends.

We are now identifying examples from the defence estate totalling in value £10-£15 million where the disposal of property can be definitely foreseen within a specified period, both with and without preparatory capital expenditure. Such a sample will be made large enough both to be worthwhile in itself and also to interest the institutions. The sample can be made to consist mostly

The Rt Hon Michael Heseltine MP



of relatively straight forward cases, excluding any with possible Cricke~~l~~ Down type complications or where there is some doubt about our longer term requirement for the property. The aim will be to put the Property Services Agency in a position, subject to our agreement, to invite bids - in whatever way seems most likely to produce results - not later than 1st May. We would need to receive the proceeds by about the second quarter of the year if the defence programme is to benefit in 1981/82; though, as I have said, receipts in later years which would not otherwise accrue would be equally welcome.

Whilst it is for my Department to identify suitable examples, we will rely on the PSA to consider, with David Young's help, the sort of terms on which the properties might be offered to the institutions. We will rely very much on the professional advice of your Department in order to ensure that deals are favourable to the defence budget, looked at both in the short and long term, and which will ensure that developers are not enabled to make a killing at the Government's expense. At the same time I am anxious that this exercise should not distract too much of the PSA's effort from the normal process of disposing in the course of 1981/82 of the considerable amount of surplus defence property already in their hands or which we expect to make available for disposal in the ordinary way.

While proposals are being drawn up for the first sample of properties to be offered to the institutions, we will be looking for a possible second tranche of projects. We will also be looking at



another type of disposal suggested by David Young, selling defence land at present let off for agricultural purposes provided suitable licenses can be developed to allow defence activities to continue. This is likely to raise rather greater difficulties in devising ways of safeguarding the Services' future training needs. But it is worth looking at.

I suggest that officials report to us jointly the results of the work they now have in hand, by the end of April. I am copying this letter to the Prime Minister in view of her earlier interest, and to Geoffrey Howe and Sir Robert Armstrong.

Yours ever
John

John Nott



CONFIDENTIAL

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~XXXXXXX~~ 218 2111/3

MO 10

28th January 1981

Dear Tim,

DEFENCE PROPERTY DISPOSALS

At her meeting on 30th December about next year's Defence Estimates, the Prime Minister suggested that the MOD disposal programme for surplus defence lands and property should be looked at again with the assistance of Mr David Young. This was discussed last week following Mr Young's return from an overseas trip: the PSA were also brought in because they are responsible for these disposals. You may wish to know the outcome.

A note is attached summarising the current facts. It was generally accepted at the meeting that on the present basis the volume of sales was unlikely to increase. It was agreed, however, that the possibility should be looked at of a change of approach in two areas, including identifying and examining a number of specific cases where early disposal might be feasible. We shall be looking at:

- a. Married quarters and other buildings which are likely to become surplus in a few years time and which might be sold and leased back for the remaining period they are required; and - as a variant of this - selling land or buildings in such a way as to raise capital for works services which need to be completed before disposal can take place;
- b. Defence land which is at present let off for agricultural purposes and might be sold subject to a licence allowing the defence activities to continue.

You may also be interested to know that officials here have been separately in touch with the Plessey Company about the way they handle property services and the lessons we might learn from this, on which we have had a useful exchange of views.

Our next meeting with Mr Young is on Friday and we will report again on the work in hand as soon as possible.

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I am sending copies of this letter to David Young, and to John Wiggins (HM Treasury), David Edmonds (Department of the Environment), and David Wright (Cabinet Office).

*Yours ever,
David Omand*

(D B OMAND)

A - DISPOSAL OF SURPLUS MOD LAND ETC

	1977/78	1978/79	1979/80	£ million	
				1980/81 (forecast)	1981/82 (Estimates)
Receipts	25	30	50	60	66
Terms agreed	18	31	75	-	-

£60m worth of property put to PSA by MOD in each of last 2 years
 £92m on hand at 30.11.80 (about the same as 12 months ago).

Houses

	<u>on hand at 30.11.80</u>	%	
Occupied	976	31	} 77
Vacant - with Agents	1,311	41	
- negotiations on transfer	169	5	
- yet to go to Agents	748	23	
	<u>3,204</u>	<u>100</u>	

Sold 1980/81

First half year	1,004
Full year (forecast)	2,000-2,500

Land and other property (including housing estates)

On hand at 30.11.80 11,000 acres

- comprising:

Agricultural	6,100
Housing	900
Industrial	1,000
Other (abandoned installations etc)	3,000

Sold 1980-81

First half year	2,185 acres
Full year (forecast)	3,500 "

2

Prime Minister



MINOR is not predicting an
excess of £262M on the revised
cash limit for this year. This means
but the total
response on the original cash limit
will be over £460M.

1. Tim
to me
2. PA.
HW
26.8

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HE

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

MC 8/2/12

22nd January 1981

HW
23

MB

Dear Leon

THE DEFENCE CASH LIMIT 1980/81:
SPRING SUPPLEMENTARY ESTIMATES

As you are aware considerable effort has been made to contain defence spending in 1980/81 within the revised cash limit of £10,492m. This is succeeding in respect of three of the four cash limited Defence Votes. But the large defence equipment Vote (Vote 2) continues to present great difficulty and, despite the stringent and wide ranging measures taken by my predecessor - three rounds of programme cuts, the three month moratorium on new commitments, and the current period of severe restraint - work on the equipment programme has continued to go ahead much faster than the Department had originally forecast and provided for. Expenditure has not been reined back to a point where I could confidently predict its being contained within the cash limit.

The present best judgement is that the equipment Votes' cash limit of £4778m is likely to be exceeded by £376m, after full account is taken of the likely effect this year of the various measures that have been taken to cut the programme.

The Rt Hon Leon Brittan MP



Introducing the scheme for monthly billing next month should reduce cash flow by a considerable amount this year and we are seeking to prevent any 'surge' in the presentation of bills at the end of March when many of our suppliers close their accounts. Though its success will depend in part on voluntary cooperation by contractors I hope that this action will help to put a firm upper limit on the size of the overspend, and we shall do whatever is possible to bring the cost outturn below the £376m. I am confident also that there will be offsetting savings on Votes other than the equipment Vote which will reduce the size of the total overspend. The present forecast is of savings of £114m which will bring the total overspending against the defence cash limit (£10,492m) down to £262m.

My officials will shortly be passing to the Treasury the additional documents necessary to support the case for seeking this additional provision.

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

John Nott
John

John Nott



Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400 GTN 213

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Rt Hon John Nott MP
Ministry of Defence
Whitehall
LONDON SW1

*Mr Whitmore -
✓
to see*

M.

21 January 1981

Dear John

*R.
... 221*

Thank you for sending me a copy of your minute to the Prime Minister of 19 January about Philip Goodhart's idea for an experimental limited scheme of entrance to the Services linked with the Youth Opportunities Programme.

I am sure there are ways in which the Ministry of Defence and the Services could offer substantial and welcome help to the Youth Opportunities Programme. They have training capacity and experience which could be most valuable. I am glad that your officials and mine are already discussing how best to take this matter further. I myself shall be meeting Philip Goodhart as soon as he thinks it would be helpful, but meanwhile I should like to make a number of preliminary points.

Since YOP is administered by the Manpower Services Commission, responsibility for accepting YOP schemes sponsored by the Services and for supervising the quality of the work experience given will rest with the MSC who should therefore be closely involved in further consideration of the matter.

There are various ways in which the Services could help with YOP. To have YOP trainees in the uniformed forces would however be a major innovation which - in view of the overtones of enlistment with all its consequences - will need careful handling. There are also many detailed questions to be considered; for example it is not clear what training in life and social skills will be given to the young people concerned. I would not want to rule out the possibility of a scheme where the trainees were much more clearly separate in status and activity from those recruited to the normal uniformed services.

I am copying this letter to the Prime Minister.

Am very keen to help

John



Secretary of State for Industry

DEPARTMENT OF INDUSTRY +PA
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

20 January 1981

Brian Norbury Esq
Private Secretary to the
Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall SW1

Dear Brian

DEFENCE EXPENDITURE STATEMENT

Thank you for circulating a copy of the draft statement Mr Nott intends to make this afternoon.

2 I am writing to confirm the points that I made to you on the telephone this morning, namely that, although we consider it would be preferable to have spelt out the implications for later years rather more fully than is done in paragraph 8 of the draft statement (and believe that it may be necessary so to do in the prospectus), we consider the present draft compatible with our disclosure requirements, provided that it is made clear that the growth "in the region of 3%" referred to in paragraph 8 is in real terms.

3 I am copying this to the private secretaries of the Chancellor, the Foreign Secretary and the Attorney, and to Tim Lankester at No 10.

Yours ever

Richard

RICHARD RILEY
Private Secretary

1. Mr Speaker, with your permission I would like to make a statement about expenditure on defence.
2. In the financial year 1981/82 defence expenditure should rise to £9753M at 1980 Survey prices. This figure is about 8% more in real terms than the defence out-turn in 1978/79, the last year of the previous Government. So far as this year is concerned we may exceed the $3\frac{1}{2}\%$ percentage rise in 1980/81 but until the out-turn is clear we cannot assess the distribution of growth between this year and next. In cash terms, although the cash limit has not yet been finalised, next year's defence budget is expected to be of the order of £12.3 billion, more than £1 billion higher than the budget this year.
3. The scale of the increase, in relation to the containment of expenditure on other programmes, fully accords with the Government's expressed determination which I re-affirm today, of giving the highest priority to our defence in the face of the growing threat from the Warsaw Pact. It also represents an increase in defence expenditure per head and raises still further the proportion of our GDP devoted to defence, which is already much higher than that of our main European allies, and close to that of the United States. Let me make it plain beyond doubt that I share without qualification the objectives stated by my predecessor in the House to sustain and improve the front line quality of our forces and our contribution to the Alliance, which remains the cornerstone of our security and the ultimate safeguard of our freedom against any aggression.

4. In accordance with these objectives, I can confirm that next year the major programme of improvements will continue. Even after trimming recruitment, there will be over 5,000 more regulars in our Services than in this financial year. A nuclear powered fleet submarine, two new air-defence destroyers, an anti-submarine frigate and several other vessels will enter service; other new warship orders, including anti-submarine carriers, nuclear-powered submarines, destroyers and frigates, together with major maritime weapon systems such as Stingray and Sub-Harpoon, will be moving forward; substantial further orders for ships and other naval equipment will be placed; and the Trident programme is under way. The Army's new Challenger tank, the new armoured personnel carrier, the Milan anti-tank and Rapier and Blowpipe air defence systems and the Ptarmigan and Clansman communications systems continue in procurement. Deliveries under the very large Tornado programme, the core of the RAF's future capability, will be accelerating. Contrary to some reports, development work on the Sea Eagle anti-ship missile will continue. ^{although further consideration will be needed before its place in the programme can be confirmed} Large sums will be spent on the Nimrod airborne early warning aircraft, improvement of our Harrier and Jaguar capability, and air-to-air defence missiles. We spend a bigger proportion of our defence budget on major equipment than any other NATO country - next year over £4000M, which will sustain hundreds of thousands of jobs, many in the highest fields of technology.

5. Nevertheless, there remain hard choices, for next year and further ahead. The problems are well known to the House, but they are worth recalling briefly. The real cost of defence equipment, much of it inevitably highly sophisticated to counter the threat, continues to rise. The recession has led industry to concentrate more heavily on defence work, with continuing effects on our cash flow. With so much of the programme already committed, it is not easy to make adjustments quickly to respond both to these factors. Defence, like other Departments, has to make adjustments every year, in all sorts of ways, to fit its programme to planned expenditure, but for the reasons I have given the scale this year is more extensive than usual. In order to avoid continuing speculation and uncertainty harmful to the Services and to industry, I think it right to give the House an early indication of the character of the adjustments and before the Defence White Paper is published.

6. The main changes which I propose accelerate the phasing out of some older equipment, the deferment of certain equipment procurements, the trimming of our works and training programmes, and further reduction of overheads; in essence, to concentrate our resources where they are most valuable.

7. Some older ships of the Royal Navy will be sold or scrapped; HMS Bulwark will be disposed of about six months earlier than planned; and planned reductions in the Vulcan force and Shackleton airborne early warning aircraft and the rundown of Canberra photographic reconnaissance squadrons will be accelerated. There will be some adjustment to the forward warship construction programme. Logistic support road₃ vehicles, Jetstream and Hawk

aircraft orders will be deferred. The Skyflash Mk 1 missile will continue, but instead of the Skyflash Mk 2 we will proceed with a programme to demonstrate a new technology for short-range air-to-air missiles. To save overheads, No 41 Commando will merge with the other Commandos, without reduction in the present overall strength of the Royal Marines and with a Royal Marine presence remaining at Deal. The Naval Communications Squadron at Lee-on-Solent will be disbanded. The extra Lightning squadron will not be formed as planned but we shall provide for a squadron to be found out of training units which could rapidly be made operational in emergency.

8. I turn now, briefly, to the future beyond next year's Estimates. The 3% annual growth in ^{defence expenditure} (resources) will continue from the revised 1981/82 baseline. Even with this increase in expenditure however, we face, as do other countries a major task in matching resources to our clear defence needs - a task made more difficult for us than for other countries because of our low growth. Talk of apocalyptic choices between key defence tasks is wide of the mark; but we must, over the next year, ~~or~~ ^{to make sure we do} look realistically at our programmes [to see what needs to ~~be done~~ ^{be done}]. We shall do this in an Alliance context and, we hope, in close concert with our Allies. But let it be clear that whatever our economic problems, the maintenance of effective security within and through the Alliance remains an overriding commitment of this Government.

DEFENCE CUTS 1981/82 (ALREADY AGREED)

£M

1. Tri-Service measures -		
a. Recruiting	12.2	Prolongs undermanning. Structural disruption. Loss of recruiting in good years before demographic trough.
b. Fuel stocks	50 (approx)	Affects war readiness and compliance with NATO standards.
c. B vehicles (general purpose, load carriers etc)	35.3	Vehicle shortages. Retention of over-age vehicles, leading to uneconomic repair. Industrial implications still under examination.
2. Sell/scrap 1 cruiser and 2 frigates	2.0	Affects declarations to NATO
3. Sell 1 additional stores ship (TARBATNESS)	3.9	
4. Sell or scrap 5 Tribal class frigates	8.9	Affects declarations to NATO
5. Dispose of HMS BULWARK 6 months early	2.6	Affects declarations to NATO
6. Disband 781 Sqn (Communi- cations) and close fixed wing function at Lee-on- Solent	2.7	Staff Side and Trade Union interests, strong local issue
7. Recast ship repair programme: cancel conversion of NORFOLK and sell (82/83). Defer ANTRIM 1 year. Delay BACCHANTE's modernisation	4.1	Industrial implications
8. Reduce Royal Marines winter training	1.9	Affects specialist rein- forcement to vulnerable area of NATO
9. Territorial Army - training, works etc	9.5	Detracts from emphasis placed on reserve forces in 1980 Statement on Defence Estimates

	£M	
10. Slow down computerised artillery target engagement system (BATES) by 1 year	1.4	Delays enhancement of artillery effectiveness in BAOR
11. Slow down delivery of mines (BARMINE)	1.4	Affects war maintenance reserve
12. Blowpipe air defence missile cancel some improvements, delay others and defer some production	4.0	Will affect Army's air defence capabilities. Industrial implications for Shorts still being examined
13. Reduction of strike Vulcans by 1 squadron equivalent, brought forward	5.5	Affects declarations to NATO in long range theatre nuclear capability. Also national strike cover.
14. Run down Canberra Photographic Recce squadrons early	1.0	Affects commitments to NATO
15. Hold Buccaneer establishment to 24	0.4	RAF maritime/strike attack capability to be reduced by one-third
16. Reduce long-range maritime patrol, Vulcan, fast jet and communications flying	31.4	Reduced capability to meet Service tasks, Fast jet measures must affect operational standards.
17. Defer purchase of 14 Jetstream and further 18 Hawk	17.2	Industrial implications
18. Defer electronic counter-measures for Jaguar	4.1	Reduces planned future capability of Jaguar
19. Reduction in Shackleton Airborne Early Warning Force	1.0	Affects declarations to NATO (Nimrod AEW not due until 1984/85)
20. Extensive further cuts in works programme for all 3 Services (other than TA)	91.7	Major industrial implications for the construction industry, felt in many parts of Britain. Very few new contracts will be let, and will take many years to recover ground lost. Comes on top of long series of works cut-backs, leading already to a seriously run-down defence estate.

DEFENCE CUTS 1981/82 - MEASURES TO BE TAKEN

	<u>£M</u>
1. Merge 41 Commando Royal Marines with other Commandos and contract facilities at Deal	3.4
2. Do not form 3rd Lightning squadron or increase establishments of existing squadrons	3.4
3. Cancel Sky Flash Mark II but continue with technology demonstration programme	11.0
4. Shipbuilding measures -	
a. Drop planned order for 6 MCMVs and advance for single role mine hunter programme (Vospers/Yarrows)	4.0
b. Order nuclear submarine SSN16 to maintain build-up to Trident, defer SSN 17-19, do not order SSN 20 or proceed with second SSN building stream (Vickers)	11.1
c. Defer SSN OZ by 4 years and conventional submarine SSK 01 by 1 year (Vickers)	7.0
d. Defer Type 44 (Yarrows)	10.0
5. Disband Nimrod (R) force	7.0

FURTHER MEASURES FROM WHICH ITEMS TO CLOSE THE REMAINING GAP WOULD
NEED TO BE CHOSEN

£M at 1980 Survey Prices

Shipbuilding

- | | | |
|----|---|------|
| a. | Defer order for 2 mine counter-
measure vessels (Vospers or Yarrows) | 2.2 |
| b. | Suspend Seabed Operations Vessel
(Scott and Lithgow) | 10.2 |
| c. | Drop order for Type 22-07 (Yarrows) | 11.9 |
| d. | Defer minesweeping trawlers | 2.4 |

Force Reductions

- | | | |
|----|--|------|
| a. | Lay up 8 Destroyer/Frigates
1 Fleet Tanker and 1 Stores
Support Ship | 12.0 |
| b. | Further reduction in Vulcan forces
(affects declarations to NATO) | 7.5 |
| c. | Reduce VC10 force by 3 aircraft | 5.0 |

51.2



MINISTRY OF DEFENCE

MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6312 (Direct Dialling)

01-218 9000 (Switchboard)

D/S of S/PS/1

20th January 1981

Dear Nick,

*PA
MS*

DEFENCE EXPENDITURE - STATEMENT

/ I attach the final version of the Statement which my Secretary of State will be making this afternoon.

I am copying this to the Private Secretaries to The Speaker, Chief Whip and Lord President.

*Yours sincerely,
Jill Ferguson*

(JILL FERGUSON)
Parliamentary Clerk

Nick Sanders Esq
10 Downing Street

1. Mr Speaker, with your permission I would like to make a statement about expenditure on defence.

2. In the financial year 1981/82 defence expenditure should rise to £9753M at 1980 Survey prices. This takes account of the reduction of £200M in planned expenditure announced earlier by my Rt hon friend the Chancellor of the Exchequer. This figure is about 8% more in real terms than the defence out-turn in 1978/79, the last year of the previous Government. So far as this year is concerned we are likely to exceed the 3% NATO aim but until the out-turn is clear we cannot assess the distribution of growth between this year and next. In cash terms, although the cash limit has not yet been finalised, next year's defence budget is expected to be of the order of £12¼ billion, more than £1 billion higher than the budget this year.

3. The scale of the increase, in relation to the containment of expenditure on other programmes, fully accords with the Government's expressed determination which I re-affirm today, of giving the highest priority to our defence in the face of the growing threat from the Warsaw Pact. It also represents an increase in defence expenditure per head at a time when the proportion of our GDP devoted to defence is already much higher than that of our main European allies, and close to that of the United States.

Let me make it plain beyond doubt that I share without qualification the objectives stated by my predecessor in the House to sustain and improve the front line quality of our forces and of our contribution to the Alliance, which remains the cornerstone of our security and the ultimate safeguard of our freedom against any aggression.

4. In accordance with these objectives, I can confirm that next year the major programme of improvements will continue. Even after trimming recruitment, there will be over 5,000 more regulars in our Services than in this financial year. A nuclear powered fleet submarine, two new air-defence destroyers, an anti-submarine frigate and several other vessels will enter service; other new warship orders, including anti-submarine carriers, nuclear-powered submarines, destroyers and frigates, together with major maritime weapon systems such as Stingray and Sub-Harpoon, will be moving forward; substantial further orders for ships and other naval equipment will be placed; and the Trident programme is under way. The Army's new Challenger tank, the new armoured personnel carrier, the Milan anti-tank and Rapier and Blowpipe air defence systems and the Ptarmigan and Clansman communications systems continue in procurement. Deliveries under the very large Tornado programme, the core of the RAF's future capability, will be accelerating.

Contrary to some reports, development work on the Sea Eagle anti-ship missile will continue although further consideration will be needed before its place in the programme can be confirmed. Large sums will be spent on the Nimrod airborne early warning aircraft, improvement of our Harrier and Jaguar capability, and air-to-air defence missiles. We spend a bigger proportion of our defence budget on major equipment than any other NATO country. Next year we shall spend over £5 billion on equipment, which will sustain hundreds of thousands of jobs, many in the highest field of technology.

5. Nevertheless, there remain hard choices, for next year and further ahead. The problems are well known to the House, but they are worth recalling briefly. The real cost of defence equipment, much of it inevitably highly sophisticated to counter the threat, continues to rise. The recession has led industry to concentrate more heavily on defence work, which means that certain equipment has come forward faster than we expected. This is to the benefit of our Services but has continuing effects on our cash flow. With so much of the programme already committed, it is not easy to make adjustments quickly. Defence, like other Departments, has to make adjustments every year, in all sorts of ways, to fit its programme to planned expenditure, but for the reasons I have given the scale this year is more extensive than usual.

In order to avoid continuing speculation and uncertainly harmful to the Services and to industry, I think it right to give the House before the Defence White Paper is published an early indication of the character of the adjustments.

6. The main changes which I propose accelerate the phasing out of some older equipment, the deferment of certain equipment procurements, the trimming of our works and training programmes, and further reduction of overheads; in essence, to concentrate our resources where they are most valuable.

7. Some older ships of the Royal Navy will be sold or scrapped; HMS BULWARK will be disposed of about six months earlier than planned and the planned reductions in the Vulcan force and Shackleton airborne early warning aircraft and the rundown of Canberra photographic reconnaissance squadrons will be accelerated. There will be some adjustment to the forward warship construction programme which will involve the slowing down of a number of orders. Logistic support road vehicles, Jetstream and Hawk aircraft orders will be deferred. The Skyflash Mk 1 missile will continue, but instead of the Skyflash Mk 2 we will proceed with a programme to demonstrate a new technology for short-range air-to-air missiles. To save overheads, No 41 Commando will merge with the other Commandos, without reduction in the present overall strength of the Royal Marines and with a continuing Royal Marine presence in Deal for the time being.

The Naval Communications Squadron at Lee-on-Solent will be disbanded. The extra Lightning squadron will not be formed as planned but we shall provide for a squadron to be found out of training units which could rapidly be made operational in emergency.

8. I turn now, briefly, to the future beyond next year's Estimates. In accordance with the expressed objective of NATO, it is our aim to continue from the revised 1981/82 base line an annual increase in defence expenditure in real terms in the region of 3%. Even with an increase in expenditure, however, we face, as do other countries a major task in matching resources to our clear defence needs - a task made more difficult for us than for other countries because of our low growth. Talk of apocalyptic choices between key defence tasks is wide of the mark; but we must, over the next year or so, look realistically at our programmes in order to match them to the resources which may be available. We shall do this in an Alliance context and, we hope, in close concert with our Allies. But let it be clear that whatever our economic problems, the maintenance of effective security within and through the Alliance remains an overriding commitment of this Government.

✓ Disposal of
Pwb. Section Assets Pkt

CONFIDENTIAL

Defence

Ref. A04026

PRIME MINISTER

Defence Estimates 1981-82
Flotation of British Aerospace

The Secretary of State for Defence sent you a minute and proposed Parliamentary statement on this subject on 16th January, which you will be considering at a meeting this afternoon. The Secretary of State for Industry has sent you a minute today on the relevance of this statement to the flotation of British Aerospace in February - see paragraphs 5-7 below.

2. The positive tone of the proposed statement is clearly the best way to tackle a difficult task. The big question about this particular approach is how it will affect our allies, particularly the United States. You will wish to take careful account of the views of the Foreign and Commonwealth Secretary on this crucial point. It is obviously to our advantage to get this statement out as long as possible before your visit to Washington in February. I can see why Mr. Nott wants to make the statement tomorrow. But you will want to consider with the Foreign and Commonwealth Secretary and the Secretary of State for Defence whether the timing is right vis-a-vis the Americans. Mr. Reagan will be concentrating on his inauguration tomorrow, and is unlikely to think about the statement at once. But its implications will undoubtedly be drawn to his attention: is there a danger that he may think that we timed the statement for Inauguration Day in the hope that he would be too busy to notice it?

3. On the substance of the statement itself, there are two general points of a positive nature which you may like to suggest should receive greater emphasis:

- (1) As one of the problems confronting the defence programme this year has been the accelerated level of deliveries from industry, there is an opportunity to deal with this phenomenon in more constructive terms than those used in paragraph 5 of the draft. Could the Secretary of State for Defence pay British industry the compliment of suggesting that part of his immediate cash flow problem stems from the over-prompt deliveries which he has been receiving from industry - which is a pleasant contrast to the accusations of late deliveries which are so often levelled at British companies?

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(2) The other positive point to which he might give greater emphasis is the fact that the proposed reductions will have little impact on the manning and equipment of the British Army of the Rhine, which is the British contribution to NATO to which our allies including the United States attach most importance. This point could be injected into paragraph 4 of the draft statement, which mentions a number of improvements which have been made in the defence programme in more general terms.

4. There is also one point of detail which you may care to suggest. I understand that No. 41 Commando is at present seriously undermanned. It might be worth mentioning this fact, if the Secretary of State for Defence can confirm its accuracy, to underline the statement that its merger with the other Commandos will not reduce the effective overall strength of the Royal Marines.

British Aerospace

5. The problem of dealing in the sales prospectus with the implications of the defence programme for British Aerospace is discussed in the minute of 7th January from the Minister of State, Department of Industry, to you and in the Secretary of State for Defence's minute to you of 16th January. There are two points in particular in the present draft statement which worry the Secretary of State for Industry:-

- (i) Paragraph 4 states that "Contrary to some reports, development work on the Sea-Eagle anti-ship missile will continue" - misleading because the possibility of cancellation is not ruled out (see paragraph 4 of the Secretary of State for Defence's minute to you).
- (ii) Paragraph 8 states "We must, over the next year or so, look realistically at our programmes to see what needs to be done" - satisfactory if it refers to the normal, ongoing process of review but difficult if it implies some more radical exercise.

The Secretary of State for Industry will, I understand, suggest drafting changes which could meet these points. He will copy his minute to the Attorney General and probably suggest that he should come to the meeting to advise on these questions.

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6. If the Secretary of State for Industry's points cannot be readily met, that adds to the case for deferring the statement until the issues can properly be thrashed out.

7. If, on the other hand, amendments can be made and it is accepted that there are no further defence problems for the British Aerospace prospectus, the way is clear for flotation subject to two points:-

(i) The Chancellor of the Exchequer accepting that February flotation should not be held up to enable a review of the BAe 146 aircraft to go ahead - the Financial Secretary appears to have accepted this in his letter of 12th January to Mr. Tebbit.

(ii) Your being satisfied that the sale of half the shares should go ahead for a net return to the Government estimated to be in the range of £15-£30 million - this is discussed in more detail in paragraphs 3 and 4 of the minute of 12th December to you from the Secretary of State for Industry in which he reported the recommendation of E(DL) that the Government should continue to aim for flotation as soon as possible in spite of the relatively low return.

ReA

ROBERT ARMSTRONG

19th January, 1981

CONFIDENTIAL

SECRET



re HFS

16.

SUBJECT

10 DOWNING STREET

From the Principal Private Secretary

19 January 1981

Dear Baron,

CS

Defence Expenditure and BAe Flotation

The Prime Minister held a meeting this afternoon with your Secretary of State, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Industry and the Attorney General to consider both the proposal made by Mr. Nott in his minute of 16 January 1981 that he should make a statement tomorrow about cuts in defence expenditure in 1981/82 and the question of the flotation of British Aerospace on which recent Ministerial correspondence rested with Sir Keith Joseph's minute of 19 January. Sir Robert Armstrong was also present.

The Defence Secretary said that he was seeking cuts which in all would total £850m. in 1981/82. Of this figure £200m. was the saving agreed by Cabinet in November; the remaining £650m., which would not be mentioned in any Parliamentary statement, was the reduction necessary to bring the programme back into line with the original PESC provision for next year. He had reviewed the measures which his predecessor had been considering and as he had explained in his minute, he had concluded that he could find only £160m. of the £200m. cut agreed by Cabinet. The changes in the programme which this reduction required reflected the Chiefs of Staff priorities. He was not happy about the merger of No. 41 RM Commando with other Commandos, but Mr. Peter Rees was ready to go along with the amalgamation, provided the RM Music School remained at Deal. He did not see how he could find the remaining saving of £40m. without adopting measures which would have a very damaging effect on the defence industries.

Mr. Nott continued that he would like to make his statement the following day. He saw every reason politically for getting the announcement about defence expenditure next year out of the way as quickly as possible. It would be no easier to make it in a month's time. Indeed if it were delayed until just before or just after the Prime Minister's visit to Washington, this would be more embarrassing than doing it now. Moreover, once decisions about next year were announced he could get down to the much greater problem of the defence programme in the medium term. He should not conceal from his colleagues, however, the fact that he would

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/have

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have to reveal in answer to supplementary questions that a considerable number of jobs would be lost as a result of the present cuts in the defence programme. Yarrows, Vosper Thorneycroft and Scott Lithgow would survive, but he expected Cammell Laird to close. About 6-7,000 job opportunities would be lost in the shipbuilding industry.

The Foreign and Commonwealth Secretary said that he did not believe that it would matter much if Mr. Nott made his statement on the day President Reagan was inaugurated; and in further discussion it was agreed that the Defence Secretary should go ahead as he proposed tomorrow.

The meeting then considered the draft statement in the light of the proposal to float British Aerospace in February. The Attorney General said that it was essential that the Defence Secretary's statement and the flotation prospectus should provide a proper understanding of our intentions in the defence field as they affected BAe. The Secretary of State for Industry said that with this general requirement in mind, he would like to see the draft statement amended in the way he had proposed in the minute which he had circulated today. First, he thought that the position on Sea Eagle should be explained more candidly than was done in paragraph 4 of the draft statement. Second, he did not think the second sentence of paragraph 8 explained explicitly enough for flotation purposes the decisions taken by Cabinet about defence expenditure in 1982/82 and 1983/84. Lastly, the fourth sentence of paragraph 8 suggested a much less radical review of the defence programme than the Defence Secretary's minute implied. In discussion it was agreed that:-

(a) The sentence about Sea Eagle in paragraph 4 of the draft statement should be amended to read:- "The Sea Eagle anti-ship missile will continue although further consideration will be needed before its place in the programme can be confirmed".

(b) The second sentence of paragraph 8 should be amended to make it clear that the reduction of £200m. in 1981/82 was carried through into the two following years, and in any case the words "defence expenditure" should be substituted for "resources". It was also desirable not to give unnecessary emphasis to the NATO commitment of 3% annual growth in real terms, now that General Haig and Mr. Weinberger were showing signs of playing down the significance of the commitment. If the Defence Secretary was asked in supplementaries whether the Government remained committed to annual increases of 3%, he should reply on the lines that the NATO commitment was clear and the Government had made plain that it abided by it.

(c) The fourth sentence of paragraph 8 should read "...is wide of the mark; but we must, over the next year, look realistically at our programmes to match them to the resources likely to be available".

/In subsequent

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In subsequent consideration of the draft statement it was agreed that the opening three or four sentences of paragraph 5 should be re-ordered and redrafted to bring out the fact that the quicker completion of defence orders had not only led to higher defence expenditure than planned but had also resulted in the Services getting new equipment more rapidly than expected. We should bring out the benefits as well as the disadvantages of the acceleration in the defence programme. On the other hand, the second sentence of paragraph 7 seemed to understate the effect of the changes in the shipbuilding programme on the warship construction programme, and the Defence Secretary agreed that he would revise this sentence to make it clearer.

Mr. Nott said that paragraph 2(b) of the Chancellor of the Exchequer's minute of 19 January about the BAe flotation assumed that any overspend on the 1980/81 cash limit for the defence budget would be offset by a compensating reduction in the 1981/82 cash limit. He did not challenge this as a reflection of general cash limit doctrine, but in the case of the MOD Cabinet had agreed in November that there should be a review of the cash limit in the summer of 1981. The fact was that if the cash overspend in the present year was clawed back in full, the defence programme would be brought to a halt. As he had explained in his minute of 16 January, to find a further saving of £40m. next year would lead to the closure of four shipyards. If he had to go substantially further than this, as he would if he had to claw back the whole of the overspend in 1980/81, the effects on defence industry would be disastrous. None the less, he would do what he could at the time of the cash limit review to offset the cash overspend in the present year.

The Chancellor of the Exchequer said that he understood the Defence Secretary's difficulties. He was ready in the mid-year review of the cash limit to take account of any exceptional movement in defence prices; the effect of Ministers' decisions on the AFPRB's recommendations; and the need, in principle, to offset in 1981/82 the overspend in 1980/81.

Mr. Nott then raised the suggestion set out in his minute of 19 January that the Youth Opportunities Programme should be expanded to allow young men and women to serve in the army. They would receive £23.50 a week and would join the army for between six and twelve months. The defence budget would meet the costs of their food, clothing and equipment, and in order to absorb them within the existing army organisation without creating new facilities for them, their number would have to be limited to something like 3,500. It was not, however, clear whether the Manpower Services Commission would be prepared to find their pay and allowances.

/In discussion

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In discussion there was general agreement on the political attractions of the proposed scheme, but it was argued that it would be unwise to take a decision on such a new departure in a rush and it would therefore not be sensible for Mr. Nott to mention the idea in his statement tomorrow.

The Prime Minister, summing up the discussion, said that the meeting agreed that Mr. Nott should make his statement on defence expenditure in 1981/82 tomorrow. He should amend the text attached to his minute of 16 January on the lines agreed in discussion and it should omit any reference to the proposal that young people participating in the Youth Opportunities Programme might serve in the army. The Defence Secretary should circulate a revised draft to all members of OD and the Attorney General by close of play today. The meeting also agreed that the Secretary of State for Industry should go ahead with the flotation of British Aerospace in February.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury), Ian Ellison (Department of Industry), Jim Nursaw (Law Officers' Department), and David Wright (Cabinet Office).

Yours etc,

Alwi Shinn

B.M. Norbury, Esq.,
Ministry of Defence.

SECRET

CONFIDENTIAL



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-836 7082 218 2111/3

MO 8/2/12

cc Mr Ingham
Mr Alexander
Mr Lancaster
Mr Sanders

19th January 1981

Prime Minister.

Dear Sir,
Agreed
mtg

This is raised by Mr NSA's review, into the changes since then.

19.

DEFENCE ESTIMATES 1981/82

My Secretary of State proposes to make a Statement in the House of Commons tomorrow afternoon, Tuesday 20th January, about next year's Defence Estimates, in particular to set in the proper context the reduction of £200 million in planned expenditure which was earlier announced by the Chancellor of the Exchequer.

I attach an advance copy of the draft which my Secretary of State has prepared in the light of consultation of those of his colleagues most immediately concerned.

I am sending copies of this letter, with the draft, to the Private Secretaries to the other members of OD, the Secretaries of State for Industry and for Employment, the Chief Whip and the Chief Whip, Lords; a copy also goes to David Wright (Cabinet Office).

Yours
Brian

(B M NORBURY)

C A Whitmore Esq

CONFIDENTIAL

DRAFT

1. Mr Speaker, with your permission I would like to make a statement about expenditure on defence.
2. In the financial year 1981/82 defence expenditure should rise to £9753M at 1980 Survey prices. This takes account of the reduction of £200M in planned expenditure announced earlier by my Rt hon friend the Chancellor of the Exchequer. This figure is about 8% more in real terms than the defence out-turn in 1978/79, the last year of the previous Government. So far as this year is concerned we are likely to exceed the 3% NATO aim but until the out-turn is clear we cannot assess the distribution of growth between this year and next. In cash terms, although the cash limit has not yet been finalised, next year's defence budget is expected to be of the order of £12.3 billion, more than £1 billion higher than the budget this year.
3. The scale of the increase, in relation to the containment of expenditure on other programmes, fully accords with the Government's expressed determination which I re-affirm today, of giving the highest priority to our defence in the face of the growing threat from the Warsaw Pact. It also represents an increase in defence expenditure per head at a time when the proportion of our GDP devoted to defence is already much higher than that of our main European allies, and close to that of the United States. Let me make it plain beyond doubt that I share without qualification the objectives stated by my predecessor in the House to sustain and improve the front

line quality of our forces and our contribution to the Alliance, which remains the cornerstone of our security and the ultimate safeguard of our freedom against any aggression.

4. In accordance with these objectives, I can confirm that next year the major programme of improvements will continue. Even after trimming recruitment, there will be over 5,000 more regulars in our Services than in this financial year. A nuclear powered fleet submarine, two new air-defence destroyers, an anti-submarine frigate and several other vessels will enter service; other new warship orders, including anti-submarine carriers, nuclear-powered submarines, destroyers and frigates, together with major maritime weapon systems such as Stingray and Sub-Harpoon, will be moving forward; substantial further orders for ships and other naval equipment will be placed; and the Trident programme is under way. The Army's new Challenger tank, the new armoured personnel carrier, the Milan anti-tank and Rapier and Blowpipe air defence systems and the Ptarmigan and Clansman communications systems continue in procurement. Deliveries under the very large Tornado programme, the core of the RAF's future capability, will be accelerating. Contrary to some reports, development work on the Sea Eagle anti-ship missile will continue although further consideration will be needed before its place in the programme can be confirmed. Large sums will be spent on the Nimrod airborne early warning aircraft, improvement of our Harrier and Jaguar capability, and air-to-air defence missiles. We spend a bigger proportion of our defence budget on major equipment than any other NATO country. Next year we shall spend over £5 billion on equipment,

which will sustain hundreds of thousands of jobs, many in the highest fields of technology.

5. Nevertheless, there remain hard choices, for next year and further ahead. The problems are well known to the House, but they are worth recalling briefly. The real cost of defence equipment, much of it inevitably highly sophisticated to counter the threat, continues to rise. The recession has led industry to concentrate more heavily on defence work, which means that certain equipment has come forward faster than we expected.

This is to the benefit of our Services but has continuing effects on our cash flow. With so much of the programme already committed, it is not easy to make adjustments quickly. Defence, like other Departments, has to make adjustments every year, in all sorts of ways, to fit its programme to planned expenditure, but for the reasons I have given the scale this year is more extensive than usual. In order to avoid continuing speculation and uncertainty harmful to the Services and to industry, I think it right to give the House before the Defence White Paper is published an early indication of the character of the adjustments.

6. The main changes which I propose accelerate the phasing out of some older equipment, the deferment of certain equipment procurements, the trimming of our works and training programmes, and further reduction of overheads; in essence, to concentrate our resources where they are most valuable.

7. Some older ships of the Royal Navy will be sold or scrapped; HMS Bulwark will be disposed of about six months earlier than planned; and planned reductions in the Vulcan

force and Shackleton airborne early warning aircraft and the rundown of Canberra photographic reconnaissance squadrons will be accelerated. There will be some adjustment to the forward warship construction programme which will involve the slowing down of a number of orders. Logistic support road vehicles, Jetstream and Hawk aircraft orders will be deferred. The Skyflash Mk 1 missile will continue, but instead of the Skyflash Mk 2 we will proceed with a programme to demonstrate a new technology for short-range air-to-air missiles. To save overheads, No 41 Commando will merge with the other Commandos, without reduction in the present overall strength of the Royal Marines and with a continuing Royal Marine presence in Deal for the time being. The Naval Communications Squadron at Lee-on-Solent will be disbanded. The extra Lightning squadron will not be formed as planned but we shall provide for a squadron to be found out of training units which could rapidly be made operational in emergency.

8. I turn now, briefly, to the future beyond next year's Estimates. In accordance with the expressed objective of NATO, it is our aim to continue from the revised 1981/82 base line an annual increase in defence expenditure in the region of 3%. Even with an increase in expenditure, however, we face, as do other countries a major task in matching resources to our clear defence needs - a task made more difficult for us than for other countries because of our low growth. Talk of apocalyptic choices between key defence tasks is wide of the mark; but we must, over the next year or so, look realistically at our

I have
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 the margin
 of the
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 1982/3
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programmes in order to match them to the resources which may be available. We shall do this in an Alliance context and, we hope, in close concert with our Allies. But let it be clear that whatever our economic problems, the maintenance of effective security within and through the Alliance remains an overriding commitment of this Government.



MO 4

PRIME MINISTER

Before we meet this afternoon I would like you to be aware of an idea put forward to me late last week by Philip Goodhart for an experimental limited scheme of Service entrance. As you may know there is an arrangement in being at the present time for young men leaving school to take a short course at Sandhurst and then join a regiment for a period of around a year as a young officer prior to joining university.

2. Philip suggested that we might extend this scheme to cover young men and women who would serve in the ranks and that this might be part of Jim Prior's youth opportunity programme. In other words the young people would receive £23.50 a week and would join the Army for a period of between six months and a year under roughly the same arrangements as they might join ICI. At the end of the period of 'youth opportunity' they would either leave the Service or be eligible together with others for full recruitment. It might be necessary in order to make sense of the scheme to have a recruitment for some reserve service in the TA at the end of the period.

3. Such an arrangement would cost the MOD budget a few million pounds in clothing and equipment but if we kept the numbers down to 5,000 and below on an experimental basis it would mainly be a marginal cost and therefore could be quite cheap. The pay and allowances being borne under the MSC budget.

4. My initial reaction is that this idea (which would not be opposed as I understand it by the General Staff) would have a



major favourable impact on the country and if I could give an idea that such a scheme was under consideration as part of the youth opportunities programme when I make my statement tomorrow I think it could be a considerable way, certainly so far as the popular press are concerned, in taking the sting out of some of our proposed measures which will of course have adverse employment consequences.

5. Obviously it is too soon to say whether this proposition is a starter - there are clear practical and other difficulties - but I think we might be sufficiently well advanced by lunchtime tomorrow whether it is safe to mention it or not. I should be glad to know whether you yourself consider it worth pursuing. I talked about this to Jim Prior over the weekend and he thought that it could have a substantial favourable impact on the country.
6. I am copying this minute only to Jim Prior at this stage.

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MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~230 7022~~ 218 2111/3

MO 8/2/12

19th January 1981

NSM

AW

Ki

Dear Clive,

DEFENCE ESTIMATES 1981/82

This letter is to record that my Secretary of State proposes to make an oral Statement in the House of Commons tomorrow afternoon to set within context the Defence Estimates for next year and in particular to explain the impact on the programme of the reduction on previously planned expenditure of £200 million. He is at present clearing the text with those of his colleagues immediately concerned, and I will circulate the draft as soon as possible.

I am sending copies of this letter to the Private Secretaries to the other members of OD and the Secretary of State for Industry, the Chief Whip and the Chief Whip in the Lords; a copy also goes to David Wright in the Cabinet Office.

*Yours and
Brian*

(B M NORBURY)

C A Whitmore Esq

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Original a Public Sechu Assch
Ptc



PRIME MINISTER

BAe FLOTATION

1 I have seen John Nott's minute to you of 16 January on the BAe flotation and on the defence estimates. I think it important, when we discuss this subject this afternoon, that the interactions between the two are fully understood. In essentials I believe that the draft statement which he proposes to make would solve most of the problems which we were concerned might frustrate a flotation. There are, however, three points on which I think that the statement would need to be more precise, so that a member of the public considering an investment in BAe shares would, by reading the statement and the prospectus, have a proper understanding of our intentions in the defence field as they apply to BAe.

2 The first is the question of disclosing the decision taken by Cabinet to reduce the defence budget by £200 million in each of the two later survey years. John proposes to deal with this by a statement that "The 3 per cent growth in resources will continue from the revised 1981/82 baseline". I am afraid that this is not quite explicit enough for flotation purposes. I think it would need to be expanded a little, so as to read "The 3 percent growth in defence expenditure in real terms will now be based on the reduced [or revised] 1981/82 baseline".

/3 ...



3 The second is his reference to Sea Eagle. His proposed statement says simply that "contrary to some reports, development work on the Sea Eagle anti-ship missile will continue". The fuller statement of the position in his minute particularly addressed to the flotation makes clear that he has not at present gone beyond a strictly temporary reprieve. This question is so material to the flotation that it is necessary that our public statements should give a complete understanding of the position. I revert to this below.

4 The third point is that the references in the statement to the need to "look realistically at our programmes over the next year or two" give me a less severe impression than his minute which talks of a need for "a fundamental look at defence commitments, roles and capabilities". As I set out in the first paragraph we must ensure that the potential investor has a proper understanding of what we intend. This statement so soon before the flotation will be the basis on which investors will be forming their views of the market prospects for defence contractors in general and BAe in particular. I would expect the prospectus to refer to it specifically. In the light of the minute I confess to doubt whether the present draft of the statement meets that test. In the last resort it is John Nott who will have to satisfy himself that his statement does meet this onerous criterion, and can be regarded as definitive. We also need to be

/clear ...



clear whether the statement supersedes any of the assurances given last week by his Permanent Secretary; if it does we would need a satisfactory restatement of the position.

5 I have referred above to the need for complete candour in the Sea Eagle position. Of the decisions which John has reached this is the only one which causes difficulty for the flotation. Because of the importance of this project as a means of developing BAe's air-launched missile technology so as to keep it competitive for further major programmes, our merchant bank advisers feel that a great degree of assurance is essential. If it were at all possible much the best course, both for the flotation and for BAe, would be to reach a firm decision now that this project could be regarded as a firm part of the programme on the basis of the proposals which BAe have made to limit and defer the costs falling on the defence budget. I do hope that John Nott could on reflection reach this view (in which case the statement could be strengthened). If, however, he cannot, and I do understand his wish to preserve options, it would be a necessary condition for flotation for the Ministry of Defence to be able to say that the present intention was that the programme should be maintained throughout 1981/2, and that their expectation was that in the event of a decision to cancel it they would take alternative steps to secure the necessary technological capability in BAe. If that were the underlying position the draft statement would need to be expanded by including the phrase "... although further decisions will be needed to confirm its place in the programme ...".



6 I have set out in full detail what is needed to enable flotation to proceed. As Norman Tebbit indicated in his minute of 7 January preparations are now far advanced for an offer on 4 February; four underwriters and three brokers are involved, and there is widespread knowledge and public comment on our plans. Kleinworts have confirmed that the defence decisions of which they were aware until Friday could be accommodated subject to the point on Sea Eagle which I have already explained, within the market capitalisation earlier foreseen (£275-300 million), not necessarily at the bottom end, and that no more than £100 million of new money will need to be raised. Thus the net proceeds seem likely to be above the bottom of the range we have contemplated. If we do not go through with it, it will be very widely known that we have pulled back at the last moment. Much worse, however, is that I must warn that in reality I see virtually no chance of a further opportunity to privatise BAe, in the life of this Parliament. The next theoretical opportunity would arise in May or June; but Kleinworts and BAe have both made clear that they do not consider the prospects nearly as good as they are now - and, in any case, there is every probability that we should be in the midst of the defence review of which John Nott has told you. I want us all to be clear therefore that to pass up our present opportunity is no mere temporary hitch, but may well be the end of a major plank of our programme, and of a Manifesto commitment.

/7 ...



7 There is a further aspect to consider. If we do not go ahead with the issue, it is inevitable that many will surmise that this is because of defence uncertainties. This will enter the public domain, and might well cast doubt upon the credibility of any statement of the sort John Nott has in mind. There are therefore defence purposes, as well as our economic and political aims, to be served by proceeding with the flotation.

8 I am copying this to John Nott, the recipients of his minute of 16 January, the Attorney General with the previous papers (because of the legal responsibilities of disclosure required of the promoter of an issue), and to Sir Robert Armstrong.

Catherine Bell

PP KEITH JOSEPH
(approved by the Secretary
of State and signed in his
absence)

January 1981

Department of Industry
Ashdown House
123 Victoria Street.

7.9.81

Original a
Public Sector Assets PM



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

PRIME MINISTER

BAE FLOTATION

I have seen Norman Tebbit's minute of 7 January to you.

2. On the three specific issues he raises:-

(a) Nigel Lawson has set out the Treasury view on the 146 review (his letter of 8 January);

(b) John Nott will wish to comment on the requirement for further Defence Budget announcements, but I should record that there is no Treasury objection to his pre-empting the Public Expenditure White Paper to the extent of revealing the agreed £200 million reductions for 1982-83 and 1983-84: the similar reduction for 1981-82 and the decision that any overspend on the 1980-81 cash limit would require a compensating deduction from the 1981-82 limit have of course already been announced;

(c) on the crucial question of the advisability of a sale in February given the level of expected receipts, my views were set out in my Private Secretary's letter of 15 December. There are financial (eg PSBR) arguments for selling as soon as possible, though I am still not satisfied that we would not do better first to bring about the cancellation of the 146. But the question is primarily political.

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3. If of course there were no real prospect of our agreeing on, and imposing, the cancellation of the 146, I would be much less uneasy about Norman Tebbit's recommendation for a February sale. Since on that scenario delay would only further reduce the likely net proceeds, there would be much to be said for going full ahead now despite the likely controversy.

4. Copies of this minute go to the other recipients of Norman Tebbit.

G. H.

(G.H.)

19 January 1981

CONFIDENTIAL



Department of Industry
 Ashdown House
 123 Victoria Street
 London SW1E 6RB

Telephone: Direct Line 01-212 0440
 Switchboard 01-212 7676

David Young
 Special Adviser

16th January, 1981

T. P. Lankester, Esq.,
 Private Secretary,
 10 Downing Street,
 London, S.W.1.

Frank Cooper

You asked David Young to look at most proposals: to first

New Tm,

I only returned from Hong Kong on Tuesday so it was only yesterday afternoon that I was able to meet with Sir Frank Cooper and Sir Arthur Hockaday at Defence.

results.

The property disposal programme of Defence is made up of a very large number of comparatively small transactions and the key to acceleration lies not so much in the hands of the PSA (who act for Defence on all property matters) but in persuading the Forces that accommodation can be relinquished in the future. There has also been an extension of the Crichton Down procedure which increases delay.

Tb. 49.

However, I have made two specific proposals:

1. that we dispose immediately of married quarters and civilian housing on terms whereby Defence would take a leaseback until such time as they can relinquish possession, at which point the purchaser would dispose of them on the open market. I might be able to put together consortia of Institutions who would buy now in anticipation of the eventual capital gain. In recent years, I financed similar transactions for U.S. forces' accommodation in this country.
2. that we dispose now of some of the agricultural land which is let on below market terms because of the proximity to Army installations. There is still a considerable shortage of agricultural investment in this country and again I believe that we might be able to interest the Institutions.

...../Cont.



- 2 -

The adoption of either or both of these courses would result in an acceleration of the disposal programme but, of course, an increased annual cost in respect of the leaseback accommodation. However, this would concentrate Defence's mind on the need to relinquish such accommodation.

Pilot projects are now being selected and I will come back to you in due course. In the meantime, I am not copying this letter.

Yours ever
David

Prime Minister.



MO 8/2/12

PRIME MINISTER

DEFENCE ESTIMATES 1981/32

? Over 0.1)
to approve.
There are important
decisions that
we have to carry out
with us. Will take
up the point at
the meeting.

As NOK compares most of the
Pym's proposed savings. There
he does not want to make
(including Sir Eagle) add up to
£40M; and he makes no proposals
for closing the gap. We shall have
to discuss how to deal with this
at Monday's meeting.
fall
16.19.

As you know, I believe that it would be right for me to make an early Statement of the further adjustments to the Defence Programme necessitated by the agreed reduction in Defence Expenditure for 1981/82. If we try to avoid giving such an indication until the publication of this year's Statement on Defence Estimates (and until your return from seeing President Reagan at the end of February) we will be subject, I believe, to a steady stream of publicity about cuts and speculation about our intentions which would be far more damaging than any adverse impact of a statement outlining the totality of the necessary measures. There is in any case no way in which I can avoid being drawn into comment next Tuesday, 20th January, when I am down for first order PQs.

2. Subject to your views, therefore, and to discussion at your meeting on Monday, I would propose to make a Statement after Questions next Tuesday on the lines of the first draft at Annex I to this minute.

3. We have a good story to tell. And my aim is to change the mood in which, because of the earlier leaks, this debate has been conducted over the past three months. Instead of the gloom which surrounds the "battle" between the Treasury and the Ministry of Defence we must get everyone talking about the tremendous contribution which this country is making to the Alliance - and the vast programme of new procurement in the next financial year.



We can present the story in a way which will encourage NATO and President Reagan. My statement is drafted on that basis.

4. On the substance, we are all agreed on the measures in Annex A to Francis Pym's minute of 23rd December which for convenience I reproduce as Annex II to this. Annex B of his minute identified measures which he was considering in order to close the gap which remained after the other savings (in his Annex A) which he had taken. Of these I am prepared, although with misgiving, to amalgamate 41 Commando Royal Marines with other Commandos, (although we will keep the Royal Marine School of Music at Deal for the time being); abandon plans to form an extra peacetime Lightning Squadron although I am considering the formation of a "shadow squadron" at negligible cost which could be found out of training units in time of tension; and to cancel the Skyflash Mk 2 missile although we will keep the technology alive with a small programme. Subject to further study, which is in progress, I also accept disbanding the special Nimrod Squadron. On the other hand I cannot accept that it is right to decide now on the cancellation of Sea Eagle - I believe that this project must continue for the time being, though I do not exclude the possibility that when I have reviewed the longer term programme later in the year I may have to cancel it, despite its operational and industrial importance. From the shipbuilding list I will implement about half the savings in Annex B of Francis' minute, including the Type 44 destroyer. These reductions will have immediate industrial consequences, particularly for the viability of Cammell Laird. I do not, however, think it right to take the remaining shipbuilding measures which Francis identified since they would have very damaging operational and industrial consequences,



/ particularly for Vosper and Scotts. For convenience I summarise at Annex III to this minute the savings which we must make.

5. The remaining gap is some £40M, and I have given much thought to how it could be closed. It could be narrowed by imposing yet greater cuts in 1981/82 on the activity of the Services eg cancelling training, (including TA training), flying and necessary stores, more than we plan already. But this kind of measure is deeply damaging to the efficiency and morale of the Services and I cannot recommend it. The alternative is yet further cuts in planned orders for new equipment, eg the shipbuilding measures which I have already referred to, or in our present force levels. An illustrative list of the kind of measures I would have to contemplate (but on which I have not yet had the advice of the Chiefs of Staff) is at Annex IV.

6. But I do not think it right to embark on yet further cuts of this kind which would have potentially the most serious consequences, both short and long term, at a time when I have still to appraise the long term defence programme. That decisions on the allocation of our resources are needed I do not doubt, but I am most concerned that these should be taken only after most careful and realistic examination of what needs to be done (and I have had today my first all day meeting with the Chiefs of Staff) and not in the context of a hurried and short term adjustment of expenditure figures.

7. I invite agreement to making a Parliamentary Statement on 20th January in the terms of my draft at Annex I; as regards Annex IV, closing the remaining gap presents me with very great



difficulties. I shall need to reflect further on how they may be resolved and, if necessary, consult my colleagues again. But I should welcome any views you and they may wish to express.

8. I am sending copies of this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Secretary of State for Industry; and to the Secretary of the Cabinet.

JW

Ministry of Defence

16th January 1981

1. Mr Speaker, with your permission I would like to make a statement about expenditure on defence.
2. In the financial year 1981/82 defence expenditure should rise to £9753M at 1980 Survey prices. This figure is about 8% more in real terms than the defence out-turn in 1978/79, the last year of the previous Government. So far as this year is concerned we may exceed the $3\frac{1}{2}\%$ percentage rise in 1980/81 but until the out-turn is clear we cannot assess the distribution of growth between this year and next. In cash terms, although the cash limit has not yet been finalised, next year's defence budget is expected to be of the order of £12.3 billion, more than £1 billion higher than the budget this year.
3. The scale of the increase, in relation to the containment of expenditure on other programmes, fully accords with the Government's expressed determination which I re-affirm today, of giving the highest priority to our defence in the face of the growing threat from the Warsaw Pact. It also represents an increase in defence expenditure per head and raises still further the proportion of our GDP devoted to defence, which is already much higher than that of our main European allies, and close to that of the United States. Let me make it plain beyond doubt that I share without qualification the objectives stated by my predecessor in the House to sustain and improve the front line quality of our forces and our contribution to the Alliance, which remains the cornerstone of our security and the ultimate safeguard of our freedom against any aggression.

4. In accordance with these objectives, I can confirm that next year the major programme of improvements will continue. Even after trimming recruitment, there will be over 5,000 more regulars in our Services than in this financial year. A nuclear powered fleet submarine, two new air-defence destroyers, an anti-submarine frigate and several other vessels will enter service; other new warship orders, including anti-submarine carriers, nuclear-powered submarines, destroyers and frigates, together with major maritime weapon systems such as Stingray and Sub-Harpoon, will be moving forward; substantial further orders for ships and other naval equipment will be placed; and the Trident programme is under way. The Army's new Challenger tank, the new armoured personnel carrier, the Milan anti-tank and Rapier and Blowpipe air defence systems and the Ptarmigan and Clansman communications systems continue in procurement. Deliveries under the very large Tornado programme, the core of the RAF's future capability, will be accelerating. Contrary to some reports, development work on the Sea Eagle anti-ship missile will continue. Large sums will be spent on the Nimrod airborne early warning aircraft, improvement of our Harrier and Jaguar capability, and air-to-air defence missiles. We spend a bigger proportion of our defence budget on major equipment than any other NATO country - next year over £4000M, which will sustain hundreds of thousands of jobs, many in the highest fields of technology.

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Phase 1
in 1985
to confirm
the
Phase
program
could
confirm
ed

5. Nevertheless, there remain hard choices, for next year and further ahead. The problems are well known to the House, but they are worth recalling briefly. The real cost of defence equipment, much of it inevitably highly sophisticated to counter the threat, continues to rise. The recession has led industry to concentrate more heavily on defence work, ^{which means that} with continuing ~~effects on our cash flow~~ ^{effects on our cash flow}. With so much of the programme already committed, it is not easy to make adjustments quickly to respond both to these factors. Defence, like other Departments, has to make adjustments every year, in all sorts of ways, to fit its programme to planned expenditure, but for the reasons I have given the scale this year is more extensive than usual. In order to avoid continuing speculation and uncertainty harmful to the Services and to industry, I think it right to give the House an early indication of the character of the adjustments and before the Defence White Paper is published.

6. The main changes which I propose accelerate the phasing out of some older equipment, the deferment of certain equipment procurements, the trimming of our works and training programmes, and further reduction of overheads; in essence, to concentrate our resources where they are most valuable.

7. Some older ships of the Royal Navy will be sold or scrapped; HMS Bulwark will be disposed of about six months earlier than planned; and planned reductions in the Vulcan force and Shackleton airborne early warning aircraft and the rundown of Canberra photographic reconnaissance squadrons will be accelerated.

There will be some adjustment to the forward warship construction programme. Logistic support road vehicles, Jetstream and Hawk

aircraft orders will be deferred. The Skyflash Mk 1 missile will continue, but instead of the Skyflash Mk 2 we will proceed with a programme to demonstrate a new technology for short-range air-to-air missiles. To save overheads, No 41 Commando will merge with the other Commandos, without reduction in the present overall strength of the Royal Marines and with a Royal Marine presence remaining at Deal. The Naval Communications Squadron at Lee-on-Solent will be disbanded. The extra Lightning squadron will not be formed as planned but we shall provide for a squadron to be found out of training units which could rapidly be made operational in emergency.

8. I turn now, briefly, to the future beyond next year's Estimates. The 3% annual growth in resources will continue from the revised 1981/82 baseline. Even with this increase in expenditure however, we face, as do other countries a major task in matching resources to our clear defence needs - a task made more difficult for us than for other countries because of our low growth. Talk of apocalyptic choices between key defence tasks is wide of the mark; but we must, over the next year ~~or~~ ^{so}, look realistically at our programmes to ~~see~~ ^{what needs to} be done. We shall do this in an Alliance context and, we hope, in close concert with our Allies: But let it be clear that whatever our economic problems, the maintenance of effective security within and through the Alliance remains an overriding commitment of this Government.

DEFENCE CUTS 1981/82 (ALREADY AGREED)

£M

- | | | |
|--|-------------|--|
| 1. Tri-Service measures - | | |
| a. Recruiting | 12.2 | Prolongs undermanning.
Structural disruption.
Loss of recruiting in good
years before demographic
trough. |
| b. Fuel stocks | 50 (approx) | Affects war readiness and
compliance with NATO
standards. |
| c. B vehicles (general
purpose, load carriers
etc) | 35.3 | Vehicle shortages.
Retention of over-age
vehicles, leading to
uneconomic repair.
Industrial implications
still under examination. |
| 2. Sell/scrap 1 cruiser and
2 frigates | 2.0 | Affects declarations to
NATO |
| 3. Sell 1 additional stores
ship (TARBATNESS) | 3.9 | |
| 4. Sell or scrap 5 Tribal
class frigates | 8.9 | Affects declarations to
NATO |
| 5. Dispose of HMS BULWARK
6 months early | 2.6 | Affects declarations to
NATO |
| 6. Disband 781 Sqn (Communi-
cations) and close fixed
wing function at Lee-on-
Solent | 2.7 | Staff Side and Trade
Union interests, strong
local issue |
| 7. Recast ship repair programme:
cancel conversion of NORFOLK
and sell (82/83). Defer
ANTRIM 1 year. Delay
BACCHANTE's modernisation | 4.1 | Industrial implications |
| 8. Reduce Royal Marines winter
training | 1.9 | Affects specialist rein-
forcement to vulnerable
area of NATO |
| 9. Territorial Army - training,
works etc | 9.5 | Detracts from emphasis
placed on reserve forces
in 1980 Statement on
Defence Estimates |

£M

- | | | |
|---|------|--|
| 10. Slow down computerised artillery target engagement system (BATES) by 1 year | 1.4 | Delays enhancement of artillery effectiveness in BAOR |
| 11. Slow down delivery of mines (BARMINE) | 1.4 | Affects war maintenance reserve |
| 12. Blowpipe air defence missile cancel some improvements, delay others and defer some production | 4.0 | Will affect Army's air defence capabilities. Industrial implications for Shorts still being examined |
| 13. Reduction of strike Vulcans by 1 squadron equivalent, brought forward | 5.5 | Affects declarations to NATO in long range theatre nuclear capability. Also national strike cover. |
| 14. Run down Canberra Photographic Recce squadrons early | 1.0 | Affects commitments to NATO |
| 15. Hold Buccaneer establishment to 24 | 0.4 | RAF maritime/strike attack capability to be reduced by one-third |
| 16. Reduce long-range maritime patrol, Vulcan, fast jet and communications flying | 31.4 | Reduced capability to meet Service tasks, Fast jet measures must affect operational standards. |
| 17. Defer purchase of 14 Jetstream and further 18 Hawk | 17.2 | Industrial implications |
| 18. Defer electronic counter-measures for Jaguar | 4.1 | Reduces planned future capability of Jaguar |
| 19. Reduction in Shackleton Airborne Early Warning Force | 1.0 | Affects declarations to NATO (Nimrod AEW not due until 1984/85) |
| 20. Extensive further cuts in works programme for all 3 Services (other than TA) | 91.7 | Major industrial implications for the construction industry, felt in many parts of Britain. Very few new contracts will be let, and will take many years to recover ground lost. Comes on top of long series of works cut-backs, leading already to a seriously run-down defence estate. |

DEFENCE CUTS 1981/82 - MEASURES TO BE TAKEN

	<u>£M</u>
1. Merge 41 Commando Royal Marines with other Commandos and contract facilities at Deal	3.4
2. Do not form 3rd Lightning squadron or increase establishments of existing squadrons	3.4
3. Cancel Sky Flash Mark II but continue with technology demonstration programme	11.0
4. Shipbuilding measures -	
a. Drop planned order for 6 MCMVs and advance for single role mine hunter programme (Vospers/Yarrows)	4.0
b. Order nuclear submarine SSN16 to maintain build-up to Trident, defer SSN 17-19, do not order SSN 20 or proceed with second SSN building stream (Vickers)	11.1
c. Defer SSN OZ by 4 years and conventional submarine SSK 01 by 1 year (Vickers)	7.0
d. Defer Type 44 (Yarrows)	10.0
5. Disband Nimrod (R) force	7.0

FURTHER MEASURES FROM WHICH ITEMS TO CLOSE THE REMAINING GAP WOULD
NEED TO BE CHOSEN

Shipbuilding£M at 1980 Survey Prices

- | | | |
|----|--|------|
| a. | Defer order for 2 mine counter-
measure vessels (<u>Vospers or Yarrows</u>) | 2.2 |
| b. | Suspend <u>Seabed Operations Vessel</u>
(Scott and Lithgow) | 10.2 |
| c. | Drop order for Type 22-07 (Yarrows) | 11.9 |
| d. | Defer minesweeping trawlers | 2.4 |

Force Reductions

- | | | |
|----|--|------|
| a. | Lay up 8 Destroyer/Frigates
1 Fleet Tanker and 1 Stores
Support Ship | 12.0 |
| b. | Further reduction in Vulcan forces
(affects declarations to NATO) | 7.5 |
| c. | <u>Reduce VC10 force by 3 aircraft</u> | 5.0 |

 51.2

? effects on
navigation?
Shant?



Am Austin

PRIME MINISTER

*D
W.*

CUTS IN DEFENCE EXPENDITURE

In his minute to you of 23 December Francis Pym gave several examples of the consequences for employment of the defence cuts he envisages - notably up to 15,000 job losses in British Shipbuilders. (I see that the Chairman of BS has told the Ministry of Defence that this will have "a catastrophic effect on the industry"). But as far as we can discover no comprehensive study has been made of the total employment effects of the cuts.

I am not of course suggesting that defence cuts should be decided according to their effects on employment. But I think that all our colleagues concerned will agree that before any final decisions are taken we should at least be aware of how extensive these effects are likely to be and, equally important, where they will occur. If you agree I hope that John Nott and Keith Joseph can let us have a note on this.

I am copying this minute to the Secretaries of State for Defence, Industry, Scotland and Wales.

J.P

16

January 1981

Original a

CONFIDENTIAL

Private

Disposal of Public Sector Assets Pte

MO 26/8/1



PRIME MINISTER

Handwritten signatures and initials, including 'A. Hutton' and 'M'.

BAe FLOTATION

Handwritten notes:
You can discuss this at the meeting with Mr. Mott on Monday, which to be done. See letter on also attending. The main substance of the letter is to be read and by below. I am told that the Committee is prepared to go along with flotation.

Play A

I have now had a chance to study the issues which arise from Norman Tebbit's minute to you of 7th January.

X

2. The first question is whether we can make public in time the £200M reductions in previously planned defence expenditure for 82/83 and 83/84 which are not at present due to be disclosed until the publication of the Public Expenditure White Paper in early March. As you know I shall be discussing with you on Monday an early general statement about next year's defence programme. This might be drafted in terms which meet this point.

Handwritten notes:
10/1

3. More difficult are the problems related to the defence workload for British Aerospace. We are able, of course, to point to our clear indication to resume 3% real growth in defence spending after next year; and we can point to a clear and distinct share of the defence budget which British Aerospace have secured in the past. But I cannot be specific now about exactly how much money they will get from us over the next few years nor about which projects they will have - nor, of course, could I for any other firm.

Y

4. I recognise the great political importance of flotation for our objectives as a Government, and its importance for a thriving aerospace sector. I am concerned, however, that the conditions for a flotation now could create difficulties for me in conducting the sort of fundamental look at defence commitments, roles, and capabilities which even a few days in office has convinced me is necessary.



5. I have been able to reprieve for the present the Sea Eagle project - a key programme I am advised for proceeding with flotation - and research and development on this will continue for the time being. I am going to negotiate with British Aerospace on the basis of a plan we have developed with them for containing future levels of expenditure in any one year, and their initiating now a review of the structure of the Dynamics Group (involving the closure of a major site) to be effected in about 5 years time. Even so, I cannot exclude the possibility that, when I come to my review of the forward programme, cancellations and adjustments affecting British Aerospace, not excluding Sea Eagle, may be necessary. If flotation proceeds, therefore, it must be on the understanding that my freedom to act is not constrained. Whether flotation can legitimately proceed on that understanding must be open to some doubt.

6. I do not know whether flotation in May would be any easier than flotation now. But given what I have said above, which must be disclosed to Kleinworts and British Aerospace, the prospectus will need to be drawn up in terms consistent with the wider objectives I have described.

7. I am copying this minute to the other members of E and to Sir Robert Armstrong.

SW

16th January 1981
Ministry of Defence

CONFIDENTIAL



File 116

10 DOWNING STREET

From the Private Secretary

13 January 1981

MISC 42: UKMTAS

The Prime Minister has noted the Chief Secretary's concurrence in the proposal put forward in Sir Robert Armstrong's minute of 4 December and the agreement of the Defence Secretary and Lord Privy Seal to it. She welcomes the satisfactory resolution of this problem.

There will now be no need for the meeting of Ministers envisaged in my minute of 15 December to Sir Robert Armstrong.

I am copying this letter to Stephen Gomersall (Lord Privy Seal's Office), Brian Norbury (Ministry of Defence) and David Wright (Cabinet Office).

T. F. Mathews, Esq.,
Chief Secretary's Office,
H.M. Treasury.

CONFIDENTIAL

9



Ref. A03977

Draft minute to come

RA

MR ALEXANDEROverseas and Defence Expenditure (Misc 42)

In my minute of 23 December last I reported signs that both Treasury and (in the end) Foreign and Commonwealth Office Ministers seemed likely to agree to the compromise suggestions for resolving this problem contained in my minute of 4 December. The Prime Minister will now have seen the then Defence Secretary's minute ^{of 23 December, the then Chief Secretary's minute} of early January and the Lord Privy Seal's minute of 7 January confirming that the compromise is acceptable to them. If the Prime Minister also agrees, there should be no need for the ad hoc meeting of Ministers envisaged in your minute to me of 15 December. But the fact that --- the Prime Minister agrees (if she does) should be recorded. I attach a draft.

RA

ROBERT ARMSTRONG

12 January 1981



DRAFT LETTER FROM MR ALEXANDER TO THE
PRIVATE SECRETARY TO THE CHIEF SECRETARY,
TREASURY

MISC42: EUKNTAS

The Prime Minister has noted the Chief Secretary's concurrence in the proposal put forward in Sir Robert Armstrong's minute of 4 December and the agreement of the Defence Secretary and Lord Privy Seal to it. She welcomes the satisfactory resolution of this problem.

2. There will now be no need for the meeting of Ministers envisaged in my minute of 15 December to Sir Robert Armstrong.

3. I am copying this letter to Stephen Gomersall Lord Privy Seal's Office, Brian Norbury, MOD, and David Wright, Cabinet Office.

Am



(2)

Prime Minister

Ln.
Pmt - 14/1

Prime Minister.

A satisfactory outcome at least
as far as UKMTAS is concerned. There
are of course other aspects of the problem
still to be pursued.

Pmt - 9/1

OVERSEAS AND DEFENCE EXPENDITURE (MISC 42)

Since the Foreign and Commonwealth Secretary minuted to you on this subject on 19 December 1980, I have seen the Defence Secretary's minute of 23 December 1980, and the Chief Secretary's minute received yesterday.

2. I note that the Chief Secretary is prepared to make available £2 million as an addition to the Foreign and Commonwealth Office programme, provided that a further £2 million is found from existing programmes; and that the Defence Secretary for his part can agree to provide £1 million from the MOD programme on the understanding that a similar sum is provided from the Foreign and Commonwealth Office for UKMTAS.

3. As the Foreign and Commonwealth Secretary said in paragraph 5 of his minute, he would have much preferred that the aid budget should not be required to contribute £1 million for this purpose. In the circumstances, however, I am now prepared to agree that £1 million should be made available from this budget as proposed by Sir Robert Armstrong. I hope this therefore enables us to go ahead on the basis that the necessary £4 million will be found in the ways now offered.

4. I am copying this minute to the Chancellor of the Exchequer, the Defence Secretary, and to Sir Robert Armstrong.

1.49.

7 January 1981



PRIME MINISTER

Original in
Public Sector Assets Pty

✓ C.C. Mur - E.J.

BAe FLOTATION

I am concerned about the extremely tight time schedule that must be met if we are not to lose the opportunity to float British Aerospace in February, especially in view of Kleinworts' advice that this would be the best and possibly the only opportunity open to us.

In Keith Joseph's absence abroad I am therefore writing in order to ensure that provided we can clear the difficulties caused by the defence review (which I am hopeful can be resolved in time) no other obstacles will remain in our way.

In Keith Joseph's minute to you of 12 December he reported the decisions of E(DL) that uncertainties about future defence programmes seemed likely to preclude flotation of British Aerospace in February, but that we should continue nevertheless to aim for flotation as soon as possible. With your agreement vesting of the business in a company, British Aerospace PLC, took place on 1 January. Simultaneously work has taken place to try to resolve the defence problems. While a solution has not yet been achieved encouraging progress has been made. There appears to be a fair prospect that such assurances as the Ministry of Defence are able to contemplate giving about their future purchases from BAe may be adequate to enable Kleinworts to proceed with a prospectus. In order to keep the February date open we are proceeding with preparations which will become increasingly public day by day. While, therefore, nothing will be wholly irrevocable until the first days of February the damage caused by a decision not to float in February is also increasing day by day, and it would be much better to call off now if we do not expect to achieve the February date.

My own very strong advice is that we should take our chances while they are available. That is in line with the conclusion of E(DL) that flotation should proceed if at all possible. Thus I recommend that we should confirm that we wish to go ahead in February, subject only to:-

- a resolution of the defence problems on a basis satisfactory to the Secretary of State for Defence, Kleinworts and our legal advisers;
- and b confirmation by Kleinworts that the proceeds will not be less than those recorded in Keith Joseph's minute of 12 December.



To reach that decision we would need to accept the points set out in the following paragraphs.

Bae 146: The Chancellor of the Exchequer considered that E Committee should review the possibility of cancellation of this project now. Adam Butler's letter of 2 January 1981 explained that this would not be compatible with flotation in February. If February in the end proves impossible we may need to revert to this question, but I suggest that we should not prejudice the February date on this account.

Announcement of Defence Budget Decisions

Although Cabinet has decided to reduce defence expenditure in each of the three survey years, the only public announcement of this has been in respect of 1981-82 and, in the normal course of events, there would be no announcement in respect of 1982-83 and 1983-84 until the Budget. I have firm legal advice, in line with that confirmed by the Attorney on our general duty as a promoter to disclose facts relevant to the issue, that we should be failing to discharge our responsibilities if we were not to disclose our overall defence decisions, since these are a relevant consideration affecting prospective investors' attitude towards a defence contractor. It is therefore necessary, if we are to bring off the flotation in which we have invested so much, for us to make an announcement, in the next fortnight, of the overall position on defence expenditure by indicating that the decision taken and announced for 1981-82 will be carried through to 1982-83 and 1983-84.

Proceeds: The conclusion of E(DL) that flotation should proceed if at all possible was reached after full consideration of the likely proceeds and the likelihood of criticism on that count. The Chancellor of the Exchequer subsequently warned again that sharp criticism was likely. There is, however, little prospect that deferral of flotation to later in this Parliament would increase the net proceeds. To be deterred by the prospective price, therefore, would be to abandon the objective of flotation in this Parliament. I therefore consider that E(DL)'s conclusion was correct.

I should be glad to know by the end of this week whether you and other colleagues agree to our proceeding on the basis I have described.

I am sending copies of this minute to the members of E and E(DL), to the Secretary of State for Defence and the Attorney General, and to Sir Robert Armstrong.

NT

NT

7 January 1980

SECRET



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10 DOWNING STREET

From the Principal Private Secretary

7 January 1981

Dear David,

PRIME MINISTER'S VISIT TO THE SAS

Thank you for your letter of 22 December 1980 which I have shown to the Prime Minister.

She has noted what you say about the existing policy on charging both for training given to foreign students in this country and for British Service personnel who are loaned to overseas governments. She agrees with your Department's view that we should be ready to modify our policy on charges for training in the United Kingdom in particular cases where we are trying to promote an important sale. Equally, she sees no reason why we should not be prepared to be flexible over the costs of loaned Service personnel. You say in your letter that you raise full costs for loaned personnel since, unlike training of foreign students in the United Kingdom, this training requires dedicated resources and is not carried on in the margins of an activity which you are undertaking for your own benefit. The Prime Minister sees the force of this argument if the matter is looked at purely in terms of the resources we allocate to the training of British forces: clearly these resources are such that the amount of foreign training that can be accommodated at their margin must be strictly limited. But another activity we undertake for our own benefit is the sale of defence equipment, and it can be argued that within the margin of our sales effort we should be ready to modify our charges for Service personnel on loan to countries where we believe there are particularly good prospects for increasing defence sales. The Prime Minister has already asked Mr. Nott to see what needs to be done to improve our sales of defence equipment overseas and she will be grateful if in his study of the general problem he could consider the desirability of making our policy on charging for loaned personnel more flexible. If we go ahead with the meeting which has been provisionally arranged for 21 January to discuss Sir Robert Armstrong's minute of 4 December 1980 on the MISC 42 report, Mr. Nott may care to report on that occasion any preliminary conclusions he has reached by then.

/The Prime Minister

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The Prime Minister was very glad to learn that British Airways have now agreed to make wide-bodied aircraft available for the SAS to practise "aircraft entry". She would like to know when the SAS have settled, to their satisfaction, the detailed arrangements with British Airways.

The Prime Minister has also noted what is being done to provide the SAS with helicopter pilots.

I am sending copies of this letter to George Walden (FCO), John Wiggins (Treasury), Stuart Hampson (D/Trade) and David Wright (Cabinet Office).

Yours sincerely,

Alvi Whitman.

D.B. Omand, Esq.,
Ministry of Defence.

RRB

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Prime Minister (through CAN)

Derek Rayner suggested that you might look at the growth of Defence R+D spending.

Treasury Chambers, Parliament Street, SW1P 3AG

M A Pattison Esq
10 Downing Street
London SW1

5 January 1981

MP
5/1

Prime Minister

Dear Mike

I think we should seek a full explanation of this increase in R+D expenditure. May we ask the MOD for a commentary?

One factor will undoubtedly be the growing expenditure in of small weapons. KLH 5i

DEFENCE RESEARCH AND DEVELOPMENT EXPENDITURE

You asked for a note on the growth of defence R & D expenditure over the past 10 years. Between 1970-71 and 1980-81 net expenditure on defence R & D has increased from £222 million to £1479 million in cash terms. At late 1979 prices the expenditure in 1970-71 is equivalent to £945 million compared with £1329 million in 1980-81, an increase of 40%. R & D accounted for 9.7% of the defence budget in 1980-81. It now takes up 13.7% of the budget. A table setting out the run of figures is attached.

You might also be interested in the breakdown between intra and extramural expenditure. Since 1975-76, the earliest year for which figures are immediately to hand, the extramural proportion has increased a little, from 63.3% of the total to 70.6% in 1980-81, but some 30% is still spent in house in the MOD research establishments.

Yours sincerely
Roger Watts

R J T WATTS

DEFENCE RESEARCH AND DEVELOPMENT EXPENDITURE

£ million

	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81
Net expenditure - Outturn Prices	222	264	330	418	433	554	699	823	872	1,151	1,479
% of Defence Budget	9.7	10.3	11.5	12.4	12.0	12.1	12.4	13.0	12.6	13.4	13.7
Net expenditure at late 1979 prices	945	1032	1177	1336	1109	1195	1188	1191	1135	1266	1329



PRIME MINISTER

OVERSEAS AND DEFENCE EXPENDITURE (MISC 42)

In his minute to you of 4 December, Sir Robert Armstrong set out for decision certain recommendations on procedures for dealing with issues relating to foreign policy and defence policy objectives. I have now examined these proposals and I am broadly content with them.

2. The most important recommendation concerns UKMTAS. It is proposed that provision for this service, as from 1981-82, should be increased from its presently projected level of £4m per annum to one of £8m per annum. Sir Robert's minute concedes that it is hard to gauge with any precision the amount which it would be right to spend, since the demand for training, and our national interest in meeting that demand, obviously vary from year to year, with changing circumstances. Moreover, it is admittedly very difficult to assess the benefits - direct and indirect - to the UK of providing such training; and the disadvantages of failing to meet overseas demand for this assistance are inevitably a matter for speculation.

3. Sir Robert Armstrong suggests that the necessary funds to meet the extra £4m should be found by an arbitrary contribution of £1m each from the existing defence budget and the existing aid budget, and that the residual £2m should be in the form of new money, allocated to the Foreign and Commonwealth programme from 1981-82 onwards.

4. In his minute of 19 December, Peter Carrington states that he is not happy that £1m should be found from the aid budget, and that he would prefer that an alternative source should be found.

5. I understand the reasons why this proposal on UKMTAS should come forward at a time when programmes have already been agreed, though it is unfortunate that the issue could not have been resolved earlier. However, provided it is firmly agreed by all concerned that half of the proposed addition of £4m would be found from within existing agreed programmes, I am prepared to agree that the other half should be an addition to the Foreign and Commonwealth Office programme. As to the future, it goes without saying that the total provision of £8m for this service would be subject to subsequent review in exactly the same way as any other part of that expenditure programme.

6. I have copied this letter to Peter Carrington and Francis Pym.

W. J. B.

JOHN BIFFEN

5. 1. 81.

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10 DOWNING STREET

From the Private Secretary

2 January 1981

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Dear David,

Defence Estimates 1981/82

As you know, the Prime Minister held a meeting with your Secretary of State, the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer on Wednesday afternoon to discuss the defence estimates for 1981/82. They had before them Mr. Pym's minute of 23 December and your two letters of 30 December.

The Prime Minister said that she was concerned about the unemployment consequences of some of the proposed spending cuts set out in annex B of Mr. Pym's minute. She was particularly concerned about the political implications of closing Deal and cancelling the Sea Eagle project both of which were in marginal constituencies. It also did not seem sensible to cancel projects which were nearing completion or on which a great deal of R and D work had already been done. In addition, she wondered whether the full budgetary consequences of particular spending decisions had been worked out. It seemed to her that all too often a reduction in the defence budget led to increased spending on social security and on other spending such as short time working compensation. In net terms, the effect of spending cuts on defence was likely to be much less than appeared at first sight. It would be far better if, before Ministers reached decisions on spending programmes, the Treasury could work out the full expenditure and PSBR implications of different options.

The Prime Minister went on to say that there was surely a case for allowing MOD to speed up their spending on equipment if this was to be offset by lower spending in later years; for by bringing spending forward this was likely to save on costs. But if the Treasury insisted on MOD finding further programme reductions in 1981/82 to offset the faster spend on equipment than had earlier been anticipated, she hoped that - as far as possible - projects could be deferred rather than cancelled. In addition, she thought that more money

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could be raised for the defence programme from property disposals. Your letter of 30 December on this subject had indicated that about £66m. could be raised from the sale of MOD land and buildings in 1981/82. But her impression was that the institutions would like to buy considerably more property than currently appeared available, and that the figure of £66m. could be increased. She suggested that the MOD disposal programme should be looked at again with the assistance of Mr. David Young. Finally, to the extent that programme reductions had to be met, she did not believe the presentational problems were quite as great as Mr. Pym suggested. She doubted whether it would be necessary to declare all of the reductions in specific terms to our NATO allies - other Governments, she felt sure, would not do so in similar circumstances; and in any case, the Government could take credit for the early completion of defence contracts.

Your Secretary of State said that the defence programme was under very great pressure. He was having to make specific programme reductions of £360m for 1981/82 because of faster than anticipated spending on equipment contracts and £200m. because of the Cabinet's November decisions on public expenditure as a whole. Nine-tenths of the defence programme was already firmly committed, so that his room for manoeuvre was very limited. The problem was made worse by rising real costs. It did not, in his view, make any sense for the Treasury to insist upon the full £360m. claw-back - since this would mean scrapping projects for which, in later years, sufficient money should be available; it would be much more reasonable if the claw-back could be spread over a period of years. If the Treasury were to insist upon additional reductions in 1981/82 to compensate for any cash overspend this year, then the whole position would become absolutely intolerable. More generally it was extremely difficult to plan on a sensible defence programme when it was subject to continued cuts: since the Government came into office, the programme had been cut five times. As regards the specific options put forward in annex B of his minute, he agreed that closing Deal and cancelling Sea Eagle would have serious political repercussions. But in terms of defence policy; item 2 of annex B - namely not forming the third Lightning Squadron or increasing establishments of existing squadrons - was much more serious. When there was a clear need to improve our air defences he was very loath to pursue this option; on the other hand, there was little alternative if savings - especially in the later years - of the magnitude required were to be achieved. The shipbuilding measures under item 5 would probably mean the closure of Cammell Laird, Scott Lithgow and Vosper's with up to 15,000 redundancies.

/The Chancellor

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The Chancellor of the Exchequer, responding to the general point about spending decisions put forward by the Prime Minister, said that the net reduction in total Government spending would be less than the spending reductions in the defence programme. But it was an illusion to think that total spending would be lower if the defence reductions were not made. Total expenditure and the PSBR would certainly be higher in the absence of the MOD reductions. If the Prime Minister's line of argument were to be pursued, this would mean reopening the decisions on defence spending reached in recent months; and it would make it impossible to resist reopening decisions on other spending programmes. As regards the £360m. claw-back, he had to insist on this simply because - in its absence - the defence budget would be overspent by that amount; if this happened, it would add to the overall financing problem and the Government would lose all credibility on public expenditure. In his view, despite the further cuts in specific defence programmes which would now be needed, the defence programme as a whole would remain basically intact. One indication of this was the formidable list of projects contained in the last paragraph of your letter of 30 December which would continue unaffected. On the other hand, the difficulties which MOD seemed to have in fulfilling their commitments within the overall programme figures suggested to him that our defence strategy was not consistent with what we could afford; and the problem was likely to become worse as spending on Trident developed in the mid-1980s. In short, we were over-committed on defence, notwithstanding the increase in spending allowed for. But he also felt that MOD's approach to spending could be improved. In contrast to other Departments, there was a tendency to give priority to the achievement of their volume programme even at the expense of exceeding their cash limits. This, he understood, was because the discussion of priorities within MOD between the three services was conducted entirely in volume terms, and because the cash limit had never been satisfactorily broken down between individual programmes. There was also, in the Treasury's view, not enough flexibility built into defence programming, and staying within the spending ceilings would be easier if MOD's long term costings were prepared on a more conservative basis.

/The Foreign and Commonwealth

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The Foreign and Commonwealth Secretary said that, from a foreign policy standpoint, he was more concerned about the proposals in Annex A of Mr. Pym's minute, than those in Annex B. Many of them would have to be declared to NATO, and the proposed reduction in fuel stocks would reduce the Services' ability to conduct training exercises. As regards the items in Annex B, he did not think it would be politically possible to disband 41 Commando Royal Marines; if Deal had to be closed, the possibility of moving them elsewhere should be considered. More generally, he agreed with the Chancellor that the defence programme was over-committed in relation to the budgetary constraints. In fact, the UK and NATO as a whole were spending more on defence than the Warsaw Pact countries; yet the overall effectiveness of our defence effort was inferior because it was spread so widely. It was necessary, in his view, for the Government to reconsider the pattern of defence spending, and it would also be highly desirable to persuade the new American Administration of the need for a review of NATO spending. The Prime Minister could put this to President Reagan when she visited the US in February.

Summing up, the Prime Minister said that the defence estimates for 1981/82 should be prepared - notwithstanding all the difficulties - on the basis of the spending decisions reached by Cabinet in November, and including whatever specific reductions were needed for the faster spending on existing contracts in 1981/82 than had earlier been anticipated. But further consideration should be given to the question of property disposals, and she would ask Mr. David Young to get in touch with Sir Frank Cooper to give assistance in this matter. On the items set out in Annex B of Mr. Pym's minute, she would like to be consulted again before final decisions were taken; and in putting forward his proposals, Mr. Pym should take into account the points made in discussion. She would also like to be consulted on the handling of all the cuts, including those in Annex A, which were to be made. Whatever final decisions were taken, they should not be made public - except in so far as it was absolutely essential to inform contractors - until the publication of the estimates and the defence White Paper in March. Finally, a re-assessment in conjunction with our allies of the pattern of defence spending would be highly desirable, and it would be for consideration over the next few weeks whether and how she should take this up with President Reagan when she visited Washington.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury), and David Wright (Cabinet Office).

David Omand, Esq.,
Ministry of Defence.

[Handwritten signature]
[Handwritten signature]

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c.c. M.V. WOLFSON

10 DOWNING STREET

From the Private Secretary

2 January, 1981.

The Prime Minister had a brief discussion with the Defence Secretary earlier this week about the possibility of expanding the sale of MOD land and buildings in the coming year. I enclose a letter dated 30 December from David Omand which summarises the MOD's current plans in this area.

In the course of the discussion, the Prime Minister expressed the view that more money, in addition to the £66 m already planned, might possibly be raised from this source - particularly in view of the fact that the institutions apparently would like to buy considerably more property than is currently available ; and she suggested that the MOD, with your assistance, should conduct an urgent re-appraisal of the disposal options. The Prime Minister said that she would ask you to get in touch with Sir Frank Cooper to provide whatever assistance you could.

The Prime Minister would be grateful if you could make contact with Sir Frank Cooper as soon as possible. There is considerable urgency about this because the defence estimates for 1981/82 have to be finalised in the next week or two, and the actual amounts in the estimates will need to take into account the receipts available from property disposals.

I am copying this letter to John Wiggins (HM Treasury), and also to David Edmonds (Department of the Environment), since the PSA will need to be involved in the further work which the Prime Minister has asked for, to Sir Frank Cooper, and to David Wright (Cabinet Office).

J. P. LANKESTER

David Young, Esq.,
Department of Industry.

V6

Ann Christie

12 -

Further notes on the points
you raised are in his
file.

T 05373

PRIME MINISTERDefence Estimates 1981/82Meeting on Wednesday 31 December at 3 pm

You are due to have a meeting on Wednesday 31 December to discuss the Defence Secretary's minute to you on this subject of 23 December. In addition to the Defence Secretary, the Foreign and Commonwealth Secretary, ^{another Chancellor} ~~a Treasury Minister~~ and ~~an Industry Minister (probably Mr Adam Butler)~~ will be present.

BACKGROUND

2. In his minute the Defence Secretary reports that the Defence Programme planned for 1981/82 is being seriously affected by two factors. These are:-
 - a. Industrial production of defence equipment has improved to such an extent that an additional £360 million has got to be found to pay for equipment in that year which is being delivered earlier than anticipated in previous plans.
 - b. The decision by the Cabinet in November which required a cut of £200 million to be made in the planned 1981/82 programme.
3. In addition to these two factors, the problem is likely to be aggravated if an overspend of the cash limit in the current year has to be recovered in 1981/82. This might amount to a further several hundred million pounds, but a precise figure will not be available until the end of the current financial year.
4. Lastly past experience suggests that the defence cash limit for 1981/82 may prove to be less than adequate, involving a hidden squeeze on the total size of the programme. But at present the Treasury believe that the proposed Defence cash limit for 1981/82 should be sufficient.
5. The Defence Secretary's minute is only concerned at this stage with the difficulties at a. and b. The sums involved are approximately 5 per cent of the planned 1981/82 defence budget for which the 1981 Survey baseline was £9947 million at 1980 Survey prices.

6. Apart from making you aware of the Defence Budget problem in 1981/82 it seems likely that one of the main aims of the Defence Secretary's minute is to seek views on the best way of making public to NATO and to Parliament the nature of the difficult decisions which have got to be taken, particularly those set out in Annex B to his minute. But you may feel that these difficulties are exaggerated and that there is insufficient recognition of the fact that the Services are being steadily better equipped and better manned, even during a period of economic depression.

HANDLING

7. You will wish to ask the Secretary of State for Defence to introduce his minute. The subsequent discussion might cover the following points:-
- a. Why does the Ministry of Defence find it so difficult to identify programme reductions of £360 million because of improvements in industrial production? Reductions of this amount have only become necessary because at an earlier stage it was assumed that there was going to be a shortfall of this amount on the programme anyhow. Surely it is better to identify those elements in the programme which the Ministry of Defence wish to defer than simply allow the process of deferment to happen by chance? The problem the Defence Programme faces here is one of management rather than of financial pressure. If it is handled properly, it must represent an improvement over the situation which always arose in the past when some deliveries were simply not made on time.
 - b. From a presentational point of view, cannot the Defence Secretary get much credit from the early deliveries which are giving rise to the need to find the additional £360 million? This is both a success story for British industry and good news for the Defence Programme if it means that newer equipment is coming into service more quickly than has been the case in the past. It must be better for example to sell or scrap five Tribal class frigates which are nearly 20 years old to make room for new warships and aircraft which are coming into service earlier than had been anticipated? These old ships must have been due to be scrapped shortly anyhow.
 - c. Does the Foreign and Commonwealth Secretary believe that the situation can be presented in these positive terms to our NATO allies? Is it necessary in any case to make any formal announcement of a number of the programme adjustments which are identified in Annex A? Many of these items are the kind of adjustments which are taking place all the time for a variety of

technical and administrative reasons.

d. Does the Defence Secretary feel that the emergence of the need to find £360 million because of the improvement in industrial production suggest that the Ministry of Defence's control of its cash flow ought to be improved? The present situation seems to suggest that there is insufficient control built into present procurement procedures.

e. How does the Department of Industry regard the proposed reduction identified in Annex A and B? To the extent that the £360 million was not due to go to British industry in this period anyhow, does it really matter if it is taken from them in the form of the measures that are identified at Annex A and B rather than in the form of the traditional shortfalls which could not be identified in advance?

f. Recognising that the apparent need to find specific programme reduction of £360 million in the 1981/82 Defence Programme does not really represent a reduction in the amount of money available for defence equipment, is it agreed that there is no reason for reconsidering the Cabinet's decision to cut that programme by £200 million as agreed last November.

g. Turning to the likely overspend in 1980/81 and the need to cover it in 1981/82, have the Defence Secretary and Chancellor of the Exchequer got any idea yet of a likely figure? Is any consequential reduction in the 1981/82 programme likely to give rise to particular presentational problems in the light of the fact that taking 1980/81 and 1981/82 together, the amount spent on defence remains unchanged?

CONCLUSION

8. Some of the measures identified in Annex B to the Defence Secretary's minute will almost certainly have been put forward by the Chiefs of Staff to make the flesh creep. Although you will wish to give the Defence Secretary every support, particularly in view of their current disgruntlement, you may care to emphasise that the only real reduction which has been made on the Defence Programme planned for 1981/82 is the £200 million which the Cabinet have agreed should be cut. There are no other real reductions. The £360 million problem should be solvable by a more

flexible managerial approach. The Defence Programme never had that money to spend and were indeed never expecting to spend it. Any recovery of the cash limit overspend in 1981/82 is balanced by the additional expenditure and the goods received for it which will have taken place in 1980/81. Constant adjustments are necessary in any large programme. Both in NATO and in Parliament the adjustments which the Defence Secretary is being required to make must be kept in the proper perspective of the rising defence programme which the United Kingdom is undertaking, in accordance with the Government's commitment to NATO and electoral promises. Highly visible cuts like the disbandment of 41 Commando Royal Marines should be avoided if possible. Savings should be made by deferments rather than cancellations, continuing pressure on the 'tail', and taking old ships and equipment out of service. Attention should be concentrated in public and in NATO on the very real improvements which are being made. The Chiefs of Staff should be encouraged to count their blessings.

R.M. Hastie-Smith

Cabinet Office
30 December 1980

R M HASTIE-SMITH



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~9307682~~ 218 2111/3

MO 8/2/12

30th December 1980

*Jen Clive,*DEFENCE ESTIMATES 1981/82

You have suggested that it would be helpful in advance of the meeting arranged for tomorrow if we were to set out in more detail the steps leading up to my Secretary of State's decisions on the Defence Estimates set out in his minute of 23rd December to the Prime Minister.

The problem we face is the scale of the total reduction needed and the short timescale in which measures must bite if they are to produce savings early enough in the Financial Year, the start of which is now only 3 months away. Only a small proportion of planned expenditure for next year remains uncommitted and reductions in this area must be correspondingly large. Furthermore, some measures which will save money in the long term can cost more in the short term, for example because of redundancy payments or the need to provide works services before bringing about redeployments.

One of the purposes of our annual Long Term Costings is to bring our physical programme assumptions (eg planned deployments and front-line strengths) into line with our financial allocations. It is our normal experience that when as part of this process Estimates are prepared each year the total cost of the programme is higher than the target to which we are working. This is brought about by the overall effect of a myriad of changes in the programme and by the annual recosting of projects, particularly those in development, which tend to show cost growth as we get closer to the spending year. In the process of screening Estimates such excesses are eliminated by pruning back individual projects, by removing items/ or deferring/and by taking account of the benefits from planned increases in efficiency, redeployments and so forth.

C A Whitmore Esq



We have done this this year but it has been more difficult than usual. This is partly because some of our room for manoeuvre has been pre-empted by the programme adjustments which have had to flow from the decisions of OD in July (based on a higher defence budget). It is also partly due to the very large number of measures taken to restrain cash spending this year, including the three-month moratorium. Although we have done our best to try and find savings measures this year, such as reduced fuel consumption, of a once-off kind, inevitably a good deal of what we have had to do has had the effect of pushing expenditure out of this year into next.

On top of this normal process we are having to cope with the unprecedented shift in assumptions about short-fall in industrial production, which as Mr Pym has said has meant finding £360m of compensating reductions elsewhere in the programme to balance the increased industrial expenditure on existing projects, and finally the volume reduction of £200m imposed by Cabinet. The Service Boards (under the Chairmanship of the Service Parliamentary Under Secretaries) and the Central Staffs under the direction of the Secretary of State have combed through every area of the programme to find the least damaging ways of making these cuts. Annex A to Mr Pym's minute set out the major measures in terms of military, political and industrial impact. Although this highlights equipment and front-line measures, it also includes substantial savings in, for example, works services (£92m), fuel stocks (£50m), and recruitment (£12m).

There is in addition a very long list of minor items where decisions have been taken to reduce expenditure, particularly in the support area, as the following examples which I have drawn at random show:-

- a. complete cancellation of the buy of binoculars for the Army next year.
- b. cuts on clothing purchases
- c. reductions in duty travel for both servicemen and civilians
- d. deferment of essential orders for locomotives for the Army (used for outloading ammunition)



- e. 20% cut in all purchases by schools and colleges
- f. reduced level of window cleaning in the Army
- g. 10% cut in Army expenditure on postage, maps etc
- h. 22½% cut in HM Ships and RFA fuel consumption
- i. 25% cut in Army non-NATO exercises
- j. reduced medical stores stocks

Moreover the vigorous search for economy in the support area, such as the R&D Establishments, continues. But it would be unwise to count confidently on securing new significant savings as soon as next year. It takes time, even after decisions in principle are reached, to consult and then to redeploy people and dispose of property.

To re-iterate the point I made at the start of this letter the room for manoeuvre in the short term is very limited. About 40% of the defence budget goes on civil and military pay and service pensions. We have a very creditable record on civilian reductions and face a daunting task in meeting the latest forward targets set by the Lord President. My Secretary of State does not believe we can go further and still meet the requirements of the programme. On service personnel, we are already planning on making savings by cutting back on recruitment.

A further 40% of the budget is spent on equipment. Much of this is already committed (typically about 90% of planned expenditure on major equipment is committed before the start of the Estimates year). This does not mean there is no scope for change (apart from cancellation): we are for example studying urgently the possibility of devising a system of cash rationing of firms for existing projects, but again we cannot count with confidence on savings here yet. Mr Pym has also been examining whether it would be possible to respond to Germany's financial worries about Tornado (on which we shall be spending nearly £700m next year) and slow the programme down, but present advice is that this would not lead to cash savings next year. Because of the contractual and industrial difficulty of reining back on projects which are well ahead, we have no alternative but to look to projects in their early stages. Because they are spending relatively little



individually, a large number have had to be cancelled or deferred. We have also had to bear in mind that reductions have also been agreed in defence budget targets in later years, and we need therefore to remove now some items scheduled to be heavy spenders later on.

There are other judgements underlying the choice of measures. Deferments of equipment may be preferable to cancellation, and bringing forward the planned phasing-out of some units (particularly the older warships) may be preferable to cutting even further into equipment in production. The RN, for example, have 2 ASW carriers, 4 nuclear submarines, 7 destroyers, 4 frigates and 8 MCMVs on order and major weapon systems such as Sub-Harpoon and Stingray. 2 Type 42 destroyers, a Type 22 frigate, 2 MCMV, 2 OPV, a new sonar and the Mk 24 Torpedo are expected into service next year. The Army have given priority to their major items such as Challenger, Ptarmigan, Clansman, Rapier, Milan and Blowpipe now on order. The RAF plans to spend £675m next year on the two types of Tornado aircraft (strike/attack and air defence), £70m on the Nimrod airborne early warning aircraft, substantial sums on the Harrier (including the improved version) and the Jaguar, and major weapons projects such as an airfield attack weapon and various air-to-air missiles, existing and projected.

I am sending copies of this letter to George Walden (FCO), John Wiggins (HM Treasury) and to David Wright (Cabinet Office).

Yours crew,

David Omand

(D B OMAND)

CONFIDENTIAL



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~9807022~~ 218 2111/3

MO 8/2/12

30th December 1980

Dear Clive,

DEFENCE ESTIMATES 1981/82:
PROPERTY DISPOSALS

You asked about the opportunities for further substantial cuts in Defence landholdings, as part of the measures necessary to take account of the reduced Defence budget for next year. The short answer is that underlying my Secretary of State's minute of 23rd December to the Prime Minister is an assumption that we can obtain receipts for the Defence budget of not less than £66 million from the sale of MOD land and buildings. These substantial receipts come on top of proceeds of the same order which we hope to receive from disposals this year. This represents a considerable speeding up of the process of disposing or making better use of under-utilised Defence property that has been in train since the early 1970s. It is a process to which the Defence Secretary has attached particular importance.

The Property Services Agency currently has some 18,000 acres of land and over 3,000 married quarters for disposal; and sizeable further disposals are planned for later years. The PSA are responsible for the sale of surplus Defence land: some of the surplus land is made available to other Government Depts or to the US Forces and in those cases receipts are not generated for the Defence budget.

The Defence Estate in the UK now comprises some 618,000 acres of freehold and leasehold land (including foreshore). This is over 40,000 acres less than in 1972. Over 60% of our land is used as training areas and ranges or for associated

C A Whitmore Esq

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CONFIDENTIAL



camps. This training land is in fact insufficient to provide the extent and variety of operational training that the Services need. In total some 277,000 acres are shared with agricultural users, although much of our total holdings are of low agricultural value and are unsuitable for housing or industrial development.

I should also mention that the Defence Secretary has asked Mr Barney Hayhoe MP, the Parliamentary Under Secretary for the Army, to take special responsibility for seeking maximum economy in the use of the Defence Estate. Action which he is overseeing include:

- a. a series of PSA/MOD Maintenance Economy Reviews of Defence Establishments, the arrangements for which have been agreed with Sir Derek Rayner. There have been 26 reviews carried out or commissioned so far, with useful results.
- b. the disposal of surplus married quarters and civilian houses. We expect to dispose of over 25,000 by various means between 1 January 1980 and 1988.
- c. a review of marginal acreages at Defence Establishments identified over 3,000 acres for disposal at nearly 50 separate locations. Further such land may be identified later.

I am copying this to George Walden (FCO), John Wiggins (HM Treasury) and David Wright (Cabinet Office).

Yours ever,

(D B OMAND)

Meeting
31st Dec

SECRET

afternoon

PRIME MINISTER

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how much saved (not
M.O.D) does it
list by
M.I.

How much saved (not
M.O.D) does it
list by
M.I.

Defence Expenditure 1981/82

The minute which we have been expecting from Mr. Pym about cuts in the defence programme next year has now arrived: it is the longer of the two minutes in the attached folder. He has also sent you another, shorter minute, emphasising that he is fully alive to the political significance of the reductions which he sees as unavoidable.

In his longer minute Mr. Pym says that, so far, he has been seeking programme cuts next year totalling £560 million. This is made up of the £200 million reduction decided upon by the Cabinet last month, together with a reduction of £360 million which he believes he must make now if he is to avoid next year the kind of overspending which he has incurred this year because industry is completing defence orders much more rapidly than it normally does. This is a very large sum to find in a year which will begin in only three months time, and some of the measures which Mr. Pym believes he will have to take to find this saving are going to be painful politically, industrially and militarily.

He has already had to decide, as part of the process of completing next year's Estimates, on a large number of measures, and these are set out in Annex A to his minute. But these do not give him all he needs, and in Annex B he lists the options he is still considering. These are plainly much more difficult than those in Annex A: they include the possible cancellation of Sea Eagle and Sky Flash Mark II and reductions in the shipbuilding programme which have already been foreshadowed in the Press.

I believe that the measures in Annex B are such that you should discuss them with Mr. Pym before he goes any further, and I have told his office this. Because they are working to finalise the list of cuts with a view to submitting their Estimates to the Treasury by 9 January, they would like any meeting to be held

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as soon as possible. Mr. Pym could see you on Wednesday 31 December (when you are in London and are free in the afternoon) or on Monday 5 January (which would involve you in returning to London from Chequers rather earlier than I think you are at present planning). Either date would give the MOD time to get their Estimates completed. Do you want to see Mr. Pym? If so, which day do you prefer?

If you have a meeting, you ought ideally to have Lord Carrington and Sir Keith Joseph there. Lord Carrington will be in this country next week but not the week after; whereas Sir Keith Joseph is abroad next week but back the following week. Whichever date you have the meeting, therefore, one of them will have to be represented by a junior Minister.

You still have to reply to Mr. Buck's letter seeking a meeting with you to discuss the defence programme. Mr. Pym thinks that you should see the officers of the Defence Committee, and Ian Gow and I believe that this is right. If you agree, it would be preferable for you to meet them in the week beginning 5 January: Mr. Pym will still be in London that week before he leaves on 11 January for the Gulf, and if decisions on the Annex B measures are taken next week or at the very beginning of the week beginning 5 January, there is a risk that they will start to leak by the week beginning 12 January and the Defence Committee will realise that they are too late to influence the course of events. But it will no doubt be difficult for the officers of the Defence Committee to come together for a meeting in that week, and they are much more likely to prefer to come to see you in the following week when the House reassembles. I enclose a letter for you to send to Mr. Buck which I have cleared with Mr. Pym's office.

You also have to reply still to Mr. Cranley Onslow's letter on the possible cancellation of Sea Eagle. I have revised the earlier reply you were given to take account of the latest developments, and the re-draft is also enclosed.

HW.

24 December 1980

SECRET



MO 8/2/12

PRIME MINISTERDEFENCE ESTIMATES 1981/82

I have sent you today a minute describing the reductions I have made, or am contemplating, in order to reduce Defence Estimates to the budget agreed last month. I am particularly concerned by the political impact this may have but I see no way of avoiding it.

2. Apart from my own constituency, where Marshall of Cambridge will come in for severe difficulties, I see serious problems arising in such marginal constituencies as Dover and Stevenage. The shipbuilding areas will react very strongly to the inevitable redundancies and we can expect trouble in other areas too.

3. I wanted you to know directly of my awareness, and to have my personal assurance that every area of possible saving has come under examination. The options for saving money next year are narrow and what is being done to get Estimates down to target really has to be. I wish it could be otherwise.

7/1

Ministry of Defence

23rd December 1980



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MT.
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MO 8/2/12

PRIME MINISTERDEFENCE ESTIMATES 1981/82

I must report to you the present position on the 1981/82 Defence Estimates.

2. Special factors make matters unusually difficult. The recession has to an unprecedented degree concentrated industrial effort on the defence programme. We must expect this to continue next year, invalidating assumptions made in earlier costings about the likely shortfall in industrial production. On this score alone we have had to find specific programme reductions of £360M at 1980 Survey prices. In addition, real costs have arisen. The Cabinet's November decisions require a further cut of £200M. Large though the defence budget is, it is a formidable task now to make cuts on the necessary scale at short notice from a programme where so much has to be committed well ahead.
3. Extensive savings were already in hand. For example, we shall make a further cut in UK based civilian employees of over 6,000, to add to a reduction of over 16,000 in 1980/81. But I have no alternative but to cut the front line, reduce war stocks and reserves, rein back Service recruitment, training and exercises, and prune future equipment programmes, with inevitable effects on industry. Annex A sets out the main measures I have already decided upon. These, with others not listed, will affect almost every aspects of defence activity, and the effects will be felt for years to come, for example a permanent reduction in the size of our destroyer and frigate force.
4. The measures so far decided would leave us still over £100M short of the target. I am considering the further measures at Annex B to close the gap. They include abandoning our recently announced plan for a third Lightning squadron for UK air defence; disbanding 41 Royal Marine Commando, which the previous Government specially reprimed; cancelling British Aerospace's Sea Eagle missile; and severe cutbacks in shipbuilding, entailing widespread redundancies. All of these items are highly visible and sensitive politically. If however I do not proceed with



these measures I shall have to find others, which we cannot expect to be less painful. This is the stark message which the Chiefs of Staff gave you when you met them last month.

5. My officials have had discussions in confidence with those major firms most significantly affected, and have kept in close touch with the Department of Industry. Major problems in the shipbuilding industry could well lead to sharp contraction of our surface warshipbuilding capacity and the direct loss of up to 15,000 jobs in the next three years. There may also be serious difficulties for the aircraft and guided weapons industry (notably at BAe, with implications for flotation), the helicopter and military vehicle industries, and some of the Royal Ordnance Factories, where numerous redundancies have already been declared and more are to come. Prospects in the electronics industry will also be hit, with particular damage in specific areas (like the electro-optical industry). It is not yet possible to specify the total loss of jobs but it will be very substantial.

6. We must present our decisions carefully with our Allies, the public and Parliament (including the House of Commons Defence Committee, which has asked for a note on the £200M cut by 9th January). I shall personally be co-ordinating the detailed handling. Many of the measures need early action if we are to save the money, but they do not all need specific announcement. It may be possible to hold some items for the "natural" occasions of our 1981 Defence White Paper (probably mid-April) and our routine July input to the NATO Defence Planning Questionnaire. Some of the many items with major industrial effects will however (when confirmed) have to become public fairly soon; and some of the near-term frontline changes have to be specially reported to NATO. I shall seek to play this last aspect in low key, but even if we succeed in muting Alliance reactions we must expect a bad reception in Parliament damaging to our overall national stance in defence, and to the particular areas of the country affected by the cuts.

7. In our public handling we must stress our commitment to continued real growth in defence expenditure, and the creditable character of our NATO contribution in the round. We can point to valuable advances we shall still be making in our defence capability in 1981/82. But we must ourselves recognise that the total effect of these measures is severe; that it will moreover extend heavily into later years; the repercussions, and those of projecting the £200M cut beyond 1981/82, will be heavy in later years; and that these facts cannot be hidden. As the Chiefs of Staff told you, they believe a broad re-appraisal

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of the pattern of our future defence effort is unavoidable.

8. I am also profoundly concerned about the consequences of a cash overspend this year, coming on top of the reductions I have described above. It is only the equipment Vote that is affected and I am looking hard at the implications which a continuation of present economic conditions could have for our future defence programme. I shall be minuting you about this in the New Year.

9. I am sending a copy of this minute to the members of Cabinet and to Sir Robert Armstrong.

Handwritten initials

Ministry of Defence

23rd December 1980

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DEFENCE CUTS 1981/82

	£M	
1. Tri-Service measures -		
a. Recruiting	12.2	Prolongs undermanning. Structural disruption. Loss of recruiting in good years before demographic trough.
b. Fuel stocks	50 (approx)	Affects war readiness and compliance with NATO standards.
c. B vehicles (general purpose, load carriers etc)	35.3	Vehicle shortages. Retention of over-age vehicles, leading to uneconomic repair. Industrial implications still under examination.
2. Sell/scrap 1 cruiser and 2 frigates	2.0	Affects declarations to NATO
3. Sell 1 additional stores ship (TARBATNESS)	3.9	
4. Sell or scrap 5 Tribal class frigates	8.9	Affects declarations to NATO
5. Dispose of HMS BULWARK 6 months early	2.6	Affects declarations to NATO
6. Disband 781 Sqn (Communications) and close fixed wing function at Lee-on-Solent	2.7	Staff Side and Trade Union interests, strong local issue
7. Recast ship repair programme: cancel conversion of NORFOLK and sell (82/83). Defer ANTRIM 1 year. Delay BACCHANTE's modernisation	4.1	Industrial implications
8. Reduce Royal Marines winter training	1.9	Affects specialist reinforcement to vulnerable area of NATO
9. Territorial Army - training, works etc	9.5	Detracts from emphasis placed on reserve forces in 1980 Statement on Defence Estimates

£M

- | | | |
|---|------|--|
| 10. Slow down computerised artillery target engagement system (BATES) by 1 year | 1.4 | Delays enhancement of artillery effectiveness in BAOR |
| 11. Slow down delivery of mines (BARMINE) | 1.4 | Affects war maintenance reserve |
| 12. Blowpipe air defence missile cancel some improvements, delay others and defer some production | 4.0 | Will affect Army's air defence capabilities. Industrial implications for Shorts still being examined |
| 13. Reduction of strike Vulcans by 1 squadron equivalent, brought forward | 5.5 | Affects declarations to NATO in long range theatre nuclear capability. Also national strike cover. |
| 14. Run down Canberra Photographic Recce squadrons early | 1.0 | Affects commitments to NATO |
| 15. Hold Buccaneer establishment to 24 | 0.4 | RAF maritime/strike attack capability to be reduced by one-third |
| 16. Reduce long-range maritime patrol, Vulcan, fast jet and communications flying | 31.4 | Reduced capability to meet Service tasks, Fast jet measures must affect operational standards. |
| 17. Defer purchase of 14 Jetstream and further 18 Hawk | 17.2 | Industrial implications |
| 18. Defer electronic counter-measures for Jaguar | 4.1 | Reduces planned future capability of Jaguar |
| 19. Reduction in Shackleton Airborne Early Warning Force | 1.0 | Affects declarations to NATO (Nimrod AEW not due until 1984/85) |
| 20. Extensive further cuts in works programme for all 3 Services (other than TA) | 91.7 | Major industrial implications for the construction industry, felt in many parts of Britain. Very few new contracts will be let, and will take many years to recover ground lost. Comes on top of long series of works cut-backs, leading already to a seriously run-down defence estate. |

DEFENCE CUTS 1981/82 -
MEASURES TO BE CONFIRMED

	<u>£M</u>	
1. Disband <u>41 Commando Royal Marines</u> , close <u>Deal</u> and reprovide some facilities at Eastney	3.4	
2. Do not form 3rd Lightning squadron or increase establishments of existing squadrons	3.4	
3. Cancel <u>Sea Eagle</u> , putting Staff Requirement into abeyance	29.7	
4. Cancel Sky Flash Mark II, abandonment of air defence improvement already announced. Gap until advance weapon available late 80's or early 90's	11.0	
5. Shipbuilding measures -		
a. Defer 2 mine counter-measure vessels, drop <u>planned</u> order for 6 and advance the single role mine hunter programme	7.5	
b. Order nuclear submarine SSN16 to maintain build-up to <u>Trident</u> , defer SSN 17-19, do not order SSN 20 or proceed with second SSN building stream	11.1	
c. Defer SSN OZ by <u>4 years</u> and conventional submarine SSK 01 by 1 year	7.0	
d. Defer Type 23 programme by <u>1</u> year and Type <u>44</u> by 5 years	14.2	
e. Drop planned order of Type 22-07 and stretch later orders	14.0	
f. Seabed Operations Vessel - stop work after launching	18.0	
g. Defer minesweeping (EDATS) trawlers 3 years	2.6	
6. Disband Nimrod (R) force	7.0	

Cannell - Laird

Scott Lithgow.

Vosper-Thornycroft.

PERSONAL CONFIDENTIAL

on file
cc Defence Feb 80,
UKMTAS.



Defence

Ref. A03887

MR. ALEXANDER

JWH
23xii

MISC 42: UKMTAS

I have just heard from Sir Douglas Wass that Treasury officials are recommending the Chief Secretary to agree to the proposal in paragraph 8 of my minute of 4th December to the Prime Minister: viz. that the financial provision for the United Kingdom military training assistance scheme (UKMTAS) should be maintained at 1979-80 levels (£8 million) in 1981-82 and thereafter, on the understanding that the additional £4 million will be found as to £2 million from the Contingency Reserve, as to £1 million from the defence budget and as to £1 million from the aid budget. The Chief Secretary is expected to accept this advice and minute accordingly after Christmas.

2. In paragraph 5 of his minute of 19th December the Foreign and Commonwealth Secretary said that he was not happy with the proposal that £1 million should be found from the aid budget, and would prefer an alternative source to be found for that £1 million. I would guess from the tone of the paragraph, however, that, if the Treasury settles for maintaining the volume of the scheme at £8 million, the Foreign and Commonwealth Secretary will reluctantly go along with finding £1 million from the aid budget.

3. With any luck this should make it unnecessary to hold a meeting to discuss my minute of 4th December.

ROBERT ARMSTRONG

23rd December, 1980

(Drafted by Sir R Armstrong
and signed on his behalf)

PERSONAL CONFIDENTIAL


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 NRP.

MW

23xi

MO 24/4

PRIME MINISTER
OVERSEAS AND DEFENCE EXPENDITURE

I have seen Sir Robert Armstrong's minute of 4th December ^{TPM} submitting the reports of the Official Group MISC 42, and suggesting how the various issues might be resolved which were left outstanding by officials.

2. If the Foreign and Commonwealth Secretary and the Chancellor are content I can agree to Sir Robert's proposals, on the understanding, which is acknowledged by officials, that my right to claim on the central contingency reserve for uncovenanted defence expenditure on evacuations or operational military assistance to Third World countries is not circumscribed in any way.

3. I am copying this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and Sir Robert Armstrong.

Ministry of Defence

23rd December 1980

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Am. Shrivasthi

953/12 T

*An internal Training
minute book the Chancellor*

SIR ANTHONY RAWLINSON

c.c. Chief Secretary *has seen, and*
Financial Secretary
Minister of State (C) *which you*
Minister of State (L) *could draw*
Sir Douglas Wass
Mr Bailey
Mr Littler *on.*
Mr Bridgeman
Miss Brown
Mr Carey
Mr Robson
Mr Ridley *R.*
Mr Cardona
Mr Kerr *3/12*

EXPENDITURE CONTROL IN MOD

There is considerable current concern about the effectiveness of the control of defence expenditure. This is of course the responsibility of the MOD. Nevertheless, the Treasury has a clear duty to monitor the course of defence expenditure during the year, and DM have in recent years maintained continuous monitoring of defence expenditure, drawn MOD's attention to divergences from the normal pattern, questioned the reasons for such divergences, made suggestions for their correction, and encouraged MOD both to take corrective action at the time when it could be effective and to develop their own monitoring and control systems to provide them with a more effective safeguard for the longer term.

2. Until recently, MOD have been loath to listen. There has been the familiar problem of conflict of objectives. MOD have tended to give priority to the achievement of their volume programme even at the expense of exceeding their cash limits. The reasons are three-fold. The inter-Service horse-trading within MOD about the future (Long Term Costings) programme is conducted entirely in volume terms; the cash limit has never - despite our urging - been satisfactorily broken down between individual programme managers; and some in the Services interpreted the Prime Minister's attitude to the 3% NATO target as a license for 3% volume growth whatever the consequences for the cash limit.

3. It was apparent early in the current financial year that MOD were on course to overspend their cash limit, and on DM advice the Chief Secretary raised the matter with Mr Pym in early June. In early August an increase, approximately half as great as that sought by Mr Pym, was granted on the express condition that it was final and that MOD would

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live within the increased limit. By September, it was apparent to DM that MOD were not taking sufficient corrective action, and the Chief Secretary drew Mr Pym's attention to this three times. MOD's response was however quite inadequate, and it is now almost certain that there will be a substantial overspend.

4. This is most unwelcome and regrettable. It is however having one welcome effect. MOD are at last convinced of the need for fresh action and their top management is at last at one with the Treasury on the need to review their internal systems to impose more effective control over cash expenditure, notwithstanding the potential impact on the achievement of volume targets.

5. Action is now in hand which is very much in line with suggestions the Treasury has been urging on MOD for some considerable time. Two studies have been commissioned:-

(a) the first study, to which priority is being given, is an urgent review of the procedures for forecasting, monitoring and controlling cash expenditure. The study will review the existing procedures and systems, consider proposals for breaking the cash limit up and providing individual cash targets for line managers and defence contractors, and assess the problems of annuality and the extent to which these might be alleviated by an acceptable degree of flexibility between years. If the CSD agree, the study will be assisted by a private sector accountant with first hand knowledge of the procurement field. It will cover the Defence Budget as a whole, but pay particular attention to the procurement area where the main risk of overspend arises. Its aim is to make recommendations for improvement within three months.

(b) The second study is a wider review of financial accountability within MOD. Starting from the reorganisation of senior financial management in MOD introduced in 1977 as a result of the management review, the objectives of the study will be:-

- (i) to ascertain whether these arrangements are working as was intended;
- (ii) to ensure that each individual with financial responsibility knows what that responsibility is and what he is accountable for;
- (iii) to define responsibility not only for Vote management but also for resources and tasks which spread across a number of

/Votes,

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Votes, and to ensure that those concerned with continuing functions eg training, hospitals, schools etc know who is responsible for the efficiency and cost-effectiveness of that activity.

We believe that the action now belatedly being taken is both necessary and right, and we have no further suggestions to make at this time. The questions under study are the key ones, long identified by the Treasury, and we would not wish to risk MOD diluting their efforts on them by ourselves now proposing further work. There is of course a risk that the recommendations of the Study Teams may not in the event be accepted by MOD. However, we think it best to wait and see what those recommendations are before suggesting further action.

6. Sir Derek Rayner has been alerted by the Treasury to the essential problems of cash control and accountability within MOD and he is keeping them in mind in formulating his next year's scrutiny programme.

7. We have also offered MOD help in their studies, drawing on our economic and analytic resources as required. We may be able to offer guidance arising from our knowledge of the control of other large cash programmes. MOD have said that they would be glad to make use of all available assistance. We shall therefore be keeping in close touch with the progress of these studies.

8. We understand that Mr Pym will be informing his colleagues shortly of the action MOD are taking and the studies now in hand.

9. When we have this month's expenditure returns, expected in early January, we shall be making a further assessment of the scale of the potential overspend this year, and submitting a full report, probably recommending the Chancellor to minute the Prime Minister.



(J E HANSFORD)

22 December 1980

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The National Archives

LETTERCODE/SERIES <i>PREM 19</i>	Date and sign
PIECE/ITEM <i>414</i> (one piece/item number)	
Extract/Item details: <i>Letter from Ormand to Alexander dated 22 December 1980</i>	
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Prime Minister.



PM/80/86

PRIME MINISTER

MISC 42

We shall be meeting on Monday morning next.

We are due to discuss the issues arising from the MISC 42 report on 21st January - but Corryton is not working for a week before Christmas (he will himself be in Morocco and Egypt for the first half of January). Shall we bring the meeting forward to next week?

- Play 'A'

19xii

1. I have seen Sir Robert Armstrong's minute to you of 4 December. Provided that we can reach agreement on the issues set out in the minute, I am content that we should not proceed with the idea of a single pocket for defence and overseas expenditure.

2. For my part, although I believe that we should accept that in principle arms may be given by HMG, I am content to accept that we should not at this stage take up the idea of a fund for doing so nor set up an arms stockpile, nor should the accounting arrangements for UKMTAS be altered.

3. As regards the cost of military operations in Third World countries, I prefer the solution that we should move the boundary between defence and overseas expenditure.

It seems to me that defence of our interests outside the NATO area and military protection or evacuation of our citizens ought to be a proper charge on the defence budget, on all fours with the use of UK Forces in NATO. Quite apart from the increase in expenditure which would be involved, I do not think that a contingency fund for the FCO is the right solution. Agreement to move the boundary coupled with a delay in actually doing it is not an administratively tidy way of proceeding. But I entirely understand that Francis Pym faces severe budgetary problems next year. In the light of this I am prepared to accept Sir Robert's suggestion that we should not move in this way until the beginning of FY 1982/83.

4. Of all the issues considered by MISC 42, I regard the future of UKMTAS as the most important. It is no exaggeration to say that this small fund produces dividends in terms of goodwill, sometimes extending to a bias in favour



of buying British defence equipment, out of all proportion to the sum involved. It enables us to show continued support for countries where we have important interests, but no troops. Moreover, it helps us to stem the spread of Soviet influence which the Russians often seek to promote by liberal use of military training and advisers. As you yourself have recognised, the French too use their much bigger programme to great advantage, often with consequent gains in the sales field. If we do not restore the level of UKMTAS to that proposed, and keep it there, the consequences will be severe. We shall have to tell many of our friends that we can no longer finance military training in this country. We may have to terminate the services of some of our training teams serving abroad. Such a situation would be a severe blow to our prestige and our credibility just at a time when, in the face of world events, we need to reassure our friends. I recognise the constraints imposed by the need to curb expenditure. But the sum involved is so small and the consequences of not providing it so stark, that some of it must be found from new money. I am also quite clear that this level of funding must be maintained for the remainder of the PESC period. The programme needs continuity.

5. However, I am not happy with the proposal that £1 million should be found towards this sum from the aid budget. This is a significant sum in terms of that budget: I need not remind you of the domestic and international criticism levelled at the aid cuts. I should therefore prefer an alternative source to be found for the £1 million.

6. It is now becoming urgent to tell our friends soon what provisions we have made for training, if they are to take full advantage of it. If we cannot agree on the way forward, I hope that you can agree that we should meet

/quickly



quickly - and certainly before Christmas.

7. I am sending copies of this minute to the Chancellor of the Exchequer, the Defence Secretary and to Sir Robert Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office

19 December 1980

019
FROM GENERAL SIR ROBERT FORD KCB CBE ADC Gen
Colonel Commandant Special Air Service



MINISTRY OF DEFENCE

MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 7544 (Direct Dialling)

01-218 9000 (Switchboard)

Defence

ADJUTANT-GENERAL

AG/100/2

TR

17 x "

C A Whitmore Esq
Principal Private Secretary
to the Prime Minister
10 Downing Street
LONDON
SW1

16 December 1980

My dear Colin,

I attach a letter which, as Colonel
Commandant Special Air Service, I have written
to the Prime Minister to say how very much her
visit to Hereford was appreciated.

*GR
Mud*

I do hope you enjoyed yourself too!

Yours ever,

Robert

CONFIDENTIAL



This is a copy. The original has been extracted and retained

BF 19/12/80

10 DOWNING STREET

From the Principal Private Secretary

15 December 1980

Dear Bonni,

PRIME MINISTER'S VISIT TO THE SAS

When the Prime Minister visited 22 SAS at Hereford on Friday of last week, a couple of points were raised with her which she would like to pursue further.

First, the Commanding Officer, Lieutenant Colonel Rose, told her that our policy for charging other countries for training assistance given to them by the SAS compared very unfavourably with the practice of the French and Germans.

Passage deleted and retained under
an FOI Exemption

AWayland
26 July 2011

The Prime Minister would be grateful if Mr. Pym could let her have, by the end of this week, a note, concerted as necessary with other Departments, explaining what our policy on charging other countries for training assistance is, its justification and how it compares with the practices of our main competitors in the defence sales field.

The second issue raised by Colonel Rose was the SAS's inability to practise what he called "aircraft entry". He said that it was important, if the SAS were to maintain their counter-hijacking skills, to be able to practise their techniques in wide-bodied aircraft. At the moment they had no access to such aircraft: they had tried to borrow wide-bodied jets from British Airways but had been turned down. The result was that other countries were now ahead of us in their ability to deal with terrorist incidents in such aircraft: the German GSG-9 team, for example, had no difficulty whatever in borrowing

/Lufthansa aircraft

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- 2 -

Lufthansa aircraft for this purpose. Colonel Rose went so far as to say that he could not be sure that he could deal successfully with a hijacking incident at Heathrow involving a wide-bodied jet. He wanted to be able to borrow one aircraft a month for 24 hours. No damage would be done to the plane.

Again, the Prime Minister would be grateful if Mr. Pym, after consulting the Secretary of State for Trade as necessary, could let her have a note on this matter by the end of the week. If the position is as Colonel Rose reported it, she is very reluctant to accept that there is nothing we can do about it.

Finally, Colonel Rose mentioned that the Ministry of Defence were considering whether the SAS should have their own dedicated helicopter pilots. The Prime Minister would be glad to know, in due course, what is decided.

I am sending copies of this letter to George Walden (FCO), John Wiggins (Treasury), Stuart Hampson (D/Trade) and David Wright (Cabinet Office).

Yours etc,

Heri Wainman.

B.M. Norbury, Esq.,
Ministry of Defence.

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LA AMT
NOV
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SR

Defence



10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG

Expenditure on Foreign Policy and
Defence Policy Objectives

The Prime Minister has seen your minute to her of 4 December on this subject. She considers that it would be useful for her to have a discussion of the issues raised with the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Secretary of State for Defence in the New Year.

I am sending copies of this minute to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury) and Brian Norbury (Ministry of Defence).

MA

15 December 1980

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CS



Defence

Treasury Chambers, Parliament Street, SW1P 3AG

D B Omand Esq
 Private Secretary to the
 Rt Hon Frances Pym MC MP
 Secretary of State
 Ministry of Defence
 Main Building
 Whitehall
 London SW1A 2HB

12 December 1980

Dear David,

12
14/12

DEFENCE CASH LIMIT 1980/81

The Chief Secretary was grateful for your letter of 3 December enclosing projections of expected cash expenditure by the Ministry of Defence month by month for the remainder of 1980/81.

These forecasts imply spending against the cash limit of £900 million, £840 million, £815 million and £637 million in the remaining months of 1980/81, compared with average spending of £906 million a month for the year to date. On the procurement Vote spending is envisaged of only £143 million in March, compared with a monthly average for the year so far of £440 million. The Chief Secretary hopes that these figures will be validated. That would be satisfactory in that it would keep to the cash limit as revised in August. It is encouraging that actual spending in November was a little less than predicted in your table. Nevertheless the realistic prospect is of a substantial overspend. The Chief Secretary asks me to record his continuing extreme concern about this.

I am sending copies of this letter to Tim Lankester and to David Wright. ✓

Yours ever,
 Terry Mathews

T F MATHEWS
 Private Secretary



MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HB

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

MO 26/2/1

11th December 1980

Dear Christopher,

2
17/12

In my letter to you of 25th November I undertook to let you know as soon as possible whether we would be able to place contracts for the four defence computers listed in your letter of 11th November. As I explained in my letter, we have been considering whether the reduced defence budget for 1981/82 could accommodate them. I can now confirm however, that we will be able to place contracts by 31st December for the three Naval Base computer bureaux, and the CRISP communications network. In the case of the Naval Base bureaux we will need to defer the presently planned delivery dates of the replacement computers by some six months in order to accommodate the cost of the programme.

You also referred, in your minute of 1st December to the Prime Minister, to a number of other MOD computer orders. I understand that we will now be able to proceed with the facilities for RAOC Bicester (system 2) and for HMS Centurion.

I am content for the other defence computer purchases mentioned in sections b. and c. of the Annex to your minute to proceed to contract in the normal way.

I am copying this letter to the Prime Minister, to other members of E Committee, to the Attorney General, and to Sir Robert Armstrong.

Francis Pym
Francis Pym

Francis Pym

We haven't dealt with training
arising from military orders.

(1)

Is that needed?
or indicated in MOD? Prime Minister

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Ref. A03729

PRIME MINISTER

(6) I imagine you will think a meeting is necessary to resolve the other problems?

This is relevant to the conversation which you had with Lord Carrington in the aircraft on the way to Dublin. Can I confirm that you believe the money for UKMTAS should come from the central contingency reserve (para 8 below)?

Am
10/4

The Defence and Overseas Policy Committee (OD) remitted for official study the notion of a "single pocket" for expenditure on foreign policy and defence policy objectives. A group of officials under Cabinet Office chairmanship has undertaken this study, and has also studied proposals for changing the accounting arrangements and increasing the financial provision for the United Kingdom military training assistance scheme (UKMTAS). The reports of the officials, circulated as MISC 42(80) 28, are attached; the conclusions are summarised in an annex to this minute.

2. The reports have been considered by the Permanent Secretaries of the Departments concerned, with whom the summary has been agreed.
3. Officials are agreed upon the conclusion that amalgamating the defence, aid and diplomatic budgets (the "single pocket") would not make it any easier to reach decisions about the marginal distribution of expenditure between defence, overseas aid and diplomatic activity and would create problems of accountability to Parliament, unless the three programmes were brought under the control of a single Minister - who would then have an intolerably large burden of responsibility.
4. If Ministers accept that conclusion, decisions are required on five issues which, though relatively minor, have eluded attempts to arrive at agreed recommendations by officials. These issues are set out in paragraph 4 of the attached summary.
5. The first issue is that of financial and accounting provision for military evacuation of British communities abroad and the provision of operational military assistance to Third World countries. At present this falls on the Foreign and Commonwealth Office (FCO) Diplomatic Budget, but there is no provision for it in the public expenditure programme: if the FCO cannot, within a relatively small programme, find savings, it has to seek provision from the central contingency reserve. The alternatives are:-



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- (i) to transfer this provision to the Ministry of Defence (MOD), because the defence budget is more likely to be able to accommodate it without the need for recourse to the central reserve;
- (ii) to give the FCO diplomatic budget a small contingency fund in its own programme, to enable it to deal with this kind of emergency; and find the money either by reducing the defence budget or by reducing the aid budget or from the central reserve;
- (iii) to leave things as they are.

✓
The FCO would prefer either (i) or (ii) (except that the ODA side of the FCO would have reservations about contributing to (ii)); the Treasury and the MOD prefer (iii). There would be much to be said for putting this contingency provision on to the defence budget. That would also accord with the logic of OD's decision on 20th March to work towards a modest enhancement of Britain's capability to intervene outside the NATO area to protect British communities or support friendly governments. I should be inclined to recommend a decision in principle accordingly; but it may be sensible to postpone its implementation by not more than a year, in the hope that the defence budget may by then be less beset than at present by the problem of overspending.

6. The second issue is how to cater for the provision of small quantities of arms to deserving Third World countries. Here I suggest:-

- (i) If Ministers decide in favour of an FCO contingency fund, the fund should cover provision of this kind.
- (ii) If Ministers decide against an FCO contingency fund, but the Foreign and Commonwealth Secretary regards the provision of up to £2½ million a year for supplying arms to Third World countries as a sufficiently high priority, the cost should be met by transfer to the diplomatic budget from the aid budget (which is statutorily precluded from being directly drawn upon for the supply of arms). Both these budgets are under the Foreign and Commonwealth Secretary's control.

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7. The third issue is whether to create a small stockpile of arms for supply to Third World countries. My meeting of Permanent Secretaries agreed that we should not create such a stockpile. Acquiring it and storing it would be additional expense; and even if we had a stockpile we could not be sure of having in it the particular types of material required in any given instance. If we do not have a stockpile, the ability to supply will depend on the Ministry of Defence having available and being able to spare (until they can be replaced) the arms required, if they are not readily available from industry.

8. The fourth issue is whether to maintain the volume of UKMTAS at 1979-80 levels. This would require an extra £4 million in 1981-82 and thereafter. There is a strong case for doing this, and I think we should. If it is to be done, where is the money to come from - the central reserve, the defence budget or the aid budget? Any division can only be arbitrary: one possibility would be to take £2 million from the reserve, £1 million from the defence budget and £1 million from the aid budget.

9. The fifth issue is the accounting arrangements for UKMTAS. My meeting of Permanent Secretaries agreed that there should be no change in these arrangements, and I recommend accordingly.

10. I am sending copies of this note, the summary, and the full reports of MISC 42 to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Secretary of State for Defence. I think that the amounts involved are too small and the issues too technical to take at OD, but I am afraid that you will need to have a meeting with these three colleagues to settle them - unless by any chance you and they are content to accept the solutions I have suggested in this minute.

REA

(Robert Armstrong)

4th December, 1980



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ANNEX

OVERSEAS AND DEFENCE EXPENDITURE

At their meeting on 5th June, OD decided, in the context of Britain's contribution to the task of countering the effects of Soviet power worldwide:

- (i) that expenditure decisions, within the overall limits agreed, should reflect the essential unity of purpose in the Government's defence and foreign policies including aid;
- (ii) that there should be further consideration how to ensure that the agreed resources available for foreign policy objectives (including aid) and defence policy objectives were treated as a "single pocket" from which expenditure could be flexibly directed towards meeting the requirements of national security in the broadest sense;
- (iii) that there should be further consideration how to introduce more realistic interdepartmental accounting between the Ministry of Defence and the Foreign and Commonwealth Office which would leave the basic costs (including a modest increase in those costs) of service personnel participating in the United Kingdom military training assistance scheme (UKMTAS) to be met from the defence budget.

2. On 17th June the Secretary of State for Defence, who had not been present at this OD meeting, sent the Prime Minister a minute reserving his position on the "single pocket" concept and expressing some doubt about the revision of interdepartmental accounting methods.

3. It was subsequently agreed that the investigation into the two subjects at (ii) and (iii) above should be undertaken initially by the interdepartmental group of officials under Cabinet Office lead (MISC 42) which had already been invited, in the Foreign and Commonwealth Secretary's minute of 25th April, to study -

- (a) the scale, nature and financing of UKMTAS, covering both inward training courses in the United Kingdom and outward secondment of British loan service personnel (LSP);
- (b) the implications of a contingency scheme to enable the United Kingdom in an emergency to provide military equipment on subsidised terms.

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4. The MISC 42 group of officials has now submitted its report, in four parts. This is attached (MISC 42(80) 28). Its conclusions may be summarised as follows:-

A. Overseas and Defence Expenditure (paragraph 1(ii) above).

There are difficult problems of resource priorities over the funding of contingencies which arise at the margin of the Defence Budget, Aid Budget and Diplomatic (i. e. FCO non-aid) Budget. Amalgamating the three Budgets would have serious practical disadvantages, in terms of Ministerial answerability to Parliament, and would not eliminate the need to decide which of their normal activities are to suffer in order to ensure that expenditure on a particular contingency is accommodated within the total ceiling. In practice the main problems arise over payment for -

- (i) Evacuation of endangered British communities abroad
- (ii) Operational assistance to friendly independent countries.

At present this expenditure falls on the Diplomatic Budget i. e. on the Foreign and Commonwealth Office (in its narrow, i. e. non-ODA, sense). There is no provision for it in the FCO's public expenditure programme, and that programme is not big enough to accommodate sizeable unforeseen extra requirements. If a contingency arises, the FCO has to seek agreement to provision from the central contingency reserve. It would like to see arrangements which made it possible to deal with contingencies of this kind - at any rate those which did not involve large sums - without recourse to the central reserve. If any change is to be made, the two practicable alternatives would be to charge provisions of this kind to the Defence Budget by altering current definitions of what constitutes normal defence expenditure, and rely on the ability of the Ministry of Defence to absorb the cost within agreed public expenditure totals - or to give the Diplomatic Budget a small contingency fund in its own programme out of which to meet expenditure of this kind (if such a fund were as large as £5 million, it could also



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cope with the financial problem identified in B. below). The FCO would like to see one or other of these alternatives adopted; the Treasury and the Ministry of Defence favour leaving matters as they are, and leaving the FCO to draw on the central contingency reserve for appropriate cases. If Ministers decided in favour of a contingency fund in the Diplomatic Budget, it would have to come out of the central contingency reserve, unless it was financed by a reduction in some other programme.

B. Provision of Military Equipment (paragraph 3. b above).

As part of Britain's contribution to countering the effect of Soviet power, the FCO attach importance to our being more able than at present to make limited quantities of arms rapidly available to friendly Third World countries who are not in a position to pay for them in full or at all. The constraints are finance and availability:

- (i) Finance. Major cases will always need to be dealt with from the central contingency reserve. Finance for smaller sums might involve £2½ million a year, which could be provided from an FCO contingency fund of £5 million as described in the second alternative under A. above, if Ministers decided in favour of that; as from the central contingency reserve.
- (ii) Availability. This problem would in the FCO's view be eased if a stockpile of basic items were established at a capital cost of rather more than £3 million over two years. But the Ministry of Defence and Treasury have practical doubts about whether this would be worthwhile; and it would in any case present an additional problem of financing, which could only be overcome by diverting further funds from (and therefore accepting further resource penalties within) one or more of the three Budgets.

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C. The Scale, Nature and Financing of UKMTAS (paragraph 3.a above).

It is highly advantageous for Britain to be able to provide military training assistance to Third World countries. It will remain necessary for some of this assistance to be paid for by Britain through UKMTAS. The programme should continue to be managed by the FCO. It is difficult to gauge with any precision the amount it would be right to spend. Demands (and British interests) vary from year to year. The benefits of meeting these demands can at best be quantified retrospectively, and the penalties of not doing so cannot be quantified at all. But in the view of departments other than the Treasury the United Kingdom could probably meet the most important demands put upon it if UKMTAS were in future funded on about the scale of 1979-80, when it paid for the training of 840 students from 42 countries and for 24 loan service personnel in 6 countries, at a cost (at 1980 survey prices) of just under £8 million. This would be $£\frac{3}{4}$ million above expected expenditure in 1980-81 and £4 million above the existing PESC provision for 1981-82 and subsequent years. Unless Ministers were willing to allocate new money to the Diplomatic Budget, from the central contingency reserve, the extra money would have to be found by means of transfers from either the Defence Budget or the Aid Budget or both. Neither the Ministry of Defence nor the ODA is able to agree to such transfers.

D. Accounting Arrangements for UKMTAS (paragraph 1(iii) above).

No change in accounting arrangements would ease the central problem of deciding what other desirable objectives should be forgone if extra resources are to be devoted to UKMTAS. There are good general reasons for continuing present practice, under which i. the MOD charges the FCO the same rates for UKMTAS customers as it charges overseas governments who themselves pay for training courses in Britain or British LSP; and ii. MOD charges as near full costs as the market will bear. Under existing accounting arrangements (which are being tightened up) the volume of UKMTAS which the FCO can afford will not be materially affected by increases or reductions in the level of MOD's charges.

Def. Exp P44

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Defence



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-230X7822 218 2111/3

MO 8/2/12

3rd December 1980

Ph Lankester

Jew Terry,

*12
5/12*

On 2nd October I sent to you and to Tim Lankester tables showing the expenditure reported under the FIS system to end-August compared with FIS profiles representative of expenditure in previous years. I added that we would be producing new profiles to reflect the action taken to restrain defence expenditure in the current year and our best assessment of the likely distribution of remaining expenditure by Vote.

You have been pressing me for the revised profiles. I now attach a table which includes FIS expenditure up to end-October. (The end-November figures should be available shortly.) The underlying assumption is that the economy measures will not be seen to be having much effect until January, given the inevitable time lag between programme adjustments and expenditure, and that the major effect will be on the procurement vote, Vote 2, which is the principle offender in terms of overspending. The figures of course also assume - and it is an important assumption - that we will be successful in our plans to influence bill paying to industry, referred to by my Secretary of State in his minute of 23rd October to the Prime Minister. The main options which we are discussing now with representatives of industry are:-

- a. completion of plans to move to a system of monthly aggregation of bills submitted by our main suppliers: the objective of these plans, which have been under consideration for some time, is to simplify procedures and to contribute to staff savings in the bill paying area. We believe that the scheme could be introduced early in 1981 in such a way as to produce no significant effect on industry's requirement for working capital but with the option of reducing our own cash flow to

T F Mathews Esq

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industry in the current financial year, possibly by a significant amount;

- b. to make clear to industry that we are not prepared to accommodate in March the 'surge' in bill presentation which has occurred in the last month of previous financial years;
- c. a reduction in payments to industry achieved either by holding back in the rate of progress of work during the remainder of the financial year or by agreeing upon reduced levels of progress payments or by both these measures.

Officials are keeping the Treasury in touch with the progress of these discussions.

I am sending a copy of this letter and enclosure to Tim Lankester (No 10) and to David Wright (Cabinet Office).

*Your ever,
David Omand*

(D B OMAND)

1980/81 DEFENCE VOTES - PROJECTIONS OF OUTTURN/CASH PROFILES

FM

FM

REPORTED FIS ACTUALS												
	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	OUTTURN
E 1: Military Civilian Pay etc												
Cumulative FIS (bookings & suspense)	383.1	768.9	1124.7	1546.8	1957.2	2319.7	2709.7	3090	3470	3880	4290	4689
Percentage of revised cash limit	8.2%	16.4%	24.0%	33.0%	41.7%	49.5%	57.8%	65.9%	74.0%	82.7%	91.5%	100%
E 2: Defence Procurement												
Cumulative FIS (bookings & suspense)	472.1	878.0	1281.7	1753.4	2143.7	2607.8	3095.2	3540	3980	4320	4635	4778
Percentage of revised cash limit	9.9%	18.4%	26.8%	36.7%	44.9%	54.6%	64.8%	74.1%	83.3%	90.4%	97.0%	100%
E 4: Defence Accommodation Services												
Cumulative FIS (bookings & suspense)	34.5	85.9	137.2	184.0	256.2	306.9	368.7	420	470	520	570	620
Percentage of revised cash limit	5.6%	13.9%	22.1%	29.7%	41.3%	49.5%	59.5%	67.7%	75.8%	83.9%	91.9%	100%
E 5: Defence Dockyard Services												
Cumulative FIS (bookings & suspense)	23.6	50.3	75.7	112.2	144.3	178.1	219.0	250	280	320	360	405
Percentage of revised cash limit	5.8%	12.4%	18.7%	27.7%	35.6%	44.0%	54.1%	61.7%	69.1%	79.0%	88.9%	100%
AL DEFENCE CASH LIMIT												
Cumulative FIS (bookings & suspense)	913.3	1783.1	2619.3	3596.4	4501.4	5412.5	6392.6	7300	8200	9040	9855	10492
Percentage of revised cash limit	8.7%	17.0%	25.0%	34.3%	42.9%	51.6%	60.9%	69.6%	78.2%	86.2%	93.9%	100%
E 3: Retired Pay, Pensions etc												
Cumulative FIS (bookings & suspense)	52.6	94.8	135.3	182.0	226.8	270.8	316.9	360	410	450	500	543
Percentage of revised Defence Estimates	9.7%	17.5%	24.9%	33.5%	41.8%	49.9%	58.4%	66.3%	75.5%	82.9%	92.1%	100%
AL DEFENCE VOTES												
Cumulative FIS (bookings & suspense)	965.9	1877.9	2754.6	3778.4	4728.2	5683.3	6709.5	7660	8610	9490	10355	11035
Percentage of revised Defence Estimates	8.6%	17.0%	25.0%	34.2%	42.8%	51.5%	60.8%	69.4%	78.0%	86.0%	93.8%	100%

PROJECTED CASH FLOW

	NOV	DEC	JAN	FEB	OUTTURN
	3090	3470	3880	4290	4689
	65.9%	74.0%	82.7%	91.5%	100%
	3540	3980	4320	4635	4778
	74.1%	83.3%	90.4%	97.0%	100%
	420	470	520	570	620
	67.7%	75.8%	83.9%	91.9%	100%
	250	280	320	360	405
	61.7%	69.1%	79.0%	88.9%	100%
	7300	8200	9040	9855	10492
	69.6%	78.2%	86.2%	93.9%	100%
	360	410	450	500	543
	66.3%	75.5%	82.9%	92.1%	100%
	7660	8610	9490	10355	11035
	69.4%	78.0%	86.0%	93.8%	100%



10 DOWNING STREET

From the Private Secretary

3 December 1980

Thank you for your letter of 3 December about the publication of a Command Paper on the United States MDAP Equipment Disposal Deposit Account 1979/80. We have no objection to the timing you propose.

I am copying this letter to Peter Moore (Chief Whip's Office).

N. D. SANDERS

Mrs Jill Ferguson
Ministry of Defence.

ds



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-9307022 218 6169

D/S of S/PQ 2279

2nd December 1980

Dear Nick,

We have discussed on the telephone on several occasions over the last day or so the way my Secretary of State proposes to make his announcement in the House today on the arming of women.

He has now given this further thought and still wishes to invoke the procedure whereby he can answer at 3.30 p.m after Prime Minister's Questions, the oral question which Antony Buck has tabled for answer today, and which lies at No 40 and would not, therefore, normally be reached.

/ I am enclosing a copy of the final answer on this.

Copies of this letter go to the Private Secretaries to the Home Secretary, the Leader of the House, the Paymaster General, the Chief Whip, the Speaker and the Secretary to the Cabinet. A copy also goes to the Chief Press Secretary at No 10.

Yours ever

Alley

(D T PIPER)

N J Sanders Esq



TUESDAY 2nd DECEMBER 1980

MR ANTONY BUCK (CONSERVATIVE)(COLCHESTER)

Mr Buck

- To ask the Secretary of State for Defence what representations he has received about the proposal that servicewomen should be allowed to bear arms, and if he will make a statement.

A N S W E R

(Mr Francis Pym)

In the Statement on the Defence Estimates (Cmd 7826) I announced that we were reconsidering our traditional attitude to the carriage of arms by servicewomen for defensive purposes. Since then, despite press coverage and the invitation in the Service debates for views to be expressed, very few representations have been received. I have concluded that there is a readiness to accept limited change and I have therefore decided that members of the Womens Services can be trained in the use of arms. At first training will be given only to a limited number. This will be voluntary in the WRAF and compulsory in the WRAC though exemptions will be made for those currently serving who have genuine objections to carrying arms. The number of WRAC involved will depend upon studies into future manpower requirements. WRAC personnel will carry arms for self-defence purposes only. The majority of the WRAF will eventually receive training; in addition to being armed for self-defence purposes they will also be armed for station defence duties.



There is no requirement at present for the WRNS to carry arms; and there is no question of members of any of the Women's services serving in a combat role.

Ministry of Defence

2nd December 1980.



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-~~907022~~ 218 6312

D/S of S/PS/1

3rd December 1980

Dear Nick,

I would be grateful for ~~your~~ approval to publish a Command Paper (United States MDAP Equipment Disposal Deposit Account 1979/80) on 17th December.

The Paper has been cleared with other interested / departments. I attach a copy of the details for your information.

This letter also goes to Peter Moore in the Chief Whips Office.

*Yours sincerely,
Jill Ferguson*

(JILL FERGUSON)
Parliamentary Clerk

N J Sanders Esq

FOREWORD

1. This Account is prepared in implementation of the Exchange of Notes between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America on 10th-13th May 1957, on the disposal of surplus United States Mutual Defence Assistance Programme equipment⁽¹⁾ as amended by a further Exchange of Notes on 17th-30th December 1958⁽²⁾, 7th-10th November 1961⁽³⁾ and 28th August 1963⁽⁴⁾.
2. The Account receives the proceeds, less certain allowable expenses, arising from the sales of equipment and material disposed of by the United Kingdom in accordance with the provisions of the Exchange of Notes.
3. The funds are used, following consultation and agreement with the United States Government, for United Kingdom projects for the defence of the NATO area additional to the defence effort of the United Kingdom or for such other projects as may be mutually agreed. Provision for expenditure on these projects is included in the Parliamentary Estimates of the departments sponsoring the projects. Corresponding provision is made for the appropriation in aid of the relevant departmental votes of the sums to be transferred from the Account to meet the expenditure incurred by departments on such projects.
4. Details are given of receipts and payments during the year ended 31st March 1980.

(1) Cmnd. 198.
 (2) Cmnd. 714.
 (3) Cmnd. 1612.
 (4) Cmnd. 2200.

UNITED STATES MDAP EQUIPMENT DISPOSAL

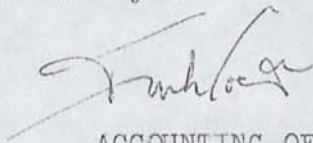
DEPOSIT ACCOUNT

Account for the year ended 31st March 1980

RECEIPTS		PAYMENTS	
	£		£
Balance at 1st April 1979	789,886		
Proceeds of sale (less agreed expenses) transferred by the under-mentioned Departments:		Department of the Environment	367,527(a)
Ministry of Defence (Navy)	455		
Ministry of Defence (Army)	2,304		
Ministry of Defence (Air)	5,931		
Ministry of Defence (Procurement Executive)	63,480		
Refund of unspent advance from the Department of the Environment	6,568	Balance 31st March 1980	501,097
	<u>868,624</u>		<u>868,624</u>

Note:

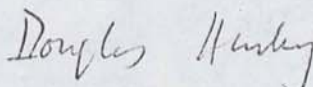
(a) Includes £10,394 spent in 1978/79 but brought to account too late to be included in the account for that year.



ACCOUNTING OFFICER

Ministry of Defence
6 October 1980

I have examined the above Account. I have obtained all the information and explanations that I have required and I certify, as the result of my audit, that in my opinion the above Account is correct.



Comptroller and Auditor General

Exchequer and Audit Department
6 November 1980

MINISTRY OF DEFENCE
UNITED STATES MDAP EQUIPMENT DISPOSAL
DEPOSIT ACCOUNT 1979/80

STATEMENT OF ASSETS AND LIABILITIES AS AT
31ST MARCH 1980

	<u>Liabilities</u>	<u>Assets</u>
	£	£
HM Paymaster General		499,509
Department of the Environment		1,588
Balance as at 31st March 1980	501,097	
	<u>501,097</u>	<u>501,097</u>

~~Xc~~



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~980 7022~~ 218 6169

cc Press Office

VPA
MS

D/S of S/PQ 2279

1st December 1980

Alan Wick,

As I mentioned to you on the telephone earlier today, Antony Buck has a Parliamentary Question down for answer tomorrow when we are the first Department for oral questions, on the arming of women. Mr Buck's question lies at No 40 and would not, therefore, be reached in the normal course of events.

I enclose a copy of the question and of the proposed answer. My Secretary of State believes that the changes which are to be announced are of sufficient importance to merit more than the written reply which an unreached oral question would normally receive. He does not, however, consider that the question merits the full treatment of a Parliamentary Statement. My Secretary of State, therefore, discussed the handling of this question with the Chief Whip and the Leader of the House, and as a result proposes to answer Mr Buck's question orally at 3.30 after Prime Minister's Question Time tomorrow.

We will, of course, discuss this with the Speaker's office tomorrow as we would for an oral statement.

I am copying this letter to Murdo Maclean (Chief Whip's Office) and Robin Birch (in the Chancellor of the Duchy's Office).

Yours ever,

Alan Wick
(D T PIPER)

N J Sanders Esq



TUESDAY 2ND DECEMBER

ANTONY BUCK (CONSERVATIVE) (COLCHESTER)

Mr Buck

To ask the Secretary of State for Defence what representations he has received about the proposal that servicewomen should be allowed to bear arms, and if he will make a statement.

A N S W E R

(Mr Francis Pym)

In the Statement on the Defence Estimates (Cmd 7826) I announced that we were reconsidering our traditional attitude to the carriage of arms by servicewomen for defensive purposes. Although there was extensive press coverage at the time and despite the invitation in the service debates for views to be expressed, interest in this subject has been very slight. I judge that there is a readiness to accept limited change and I have therefore decided that members of the Womens Services can be trained in the use of arms. At first training will be given only to a limited number. This will be voluntary in the WRAF and compulsory in the WRAC though exemptions will be made for those currently serving who have genuine objections to carrying arms. The number of WRAC involved will depend upon studies into future manpower requirements. WRAC personnel will carry arms for self-defence purposes only. The majority of the WRAF will eventually receive training; in addition to being armed for self-defence purposes they will also be armed for station defence duties.

There is no requirement at present for the WRNS to carry arms; and there is no question of members of any of the Women's services serving in a combat role.

Tuesday 2nd December

Ministry of Defence

cc B. H. G. 2.



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 2111/3 (Direct Dialling)
01-218 9000 (Switchboard)

MD

PRIME MINISTER

MO 4

27th November 1980

On reconsideration, Mr Pym is getting cold feet about announcing this by written answer - but I doubt that it

Prime Minister

John Nal merits a statement or PNQ MS 2/11

For information Mr Pym does not expect serious controversy. *MD*

ARMING OF SERVICEWOMEN

In the Statement on Defence Estimates 1980 (Cmnd 7826-I, para 626-8) the Defence Secretary said that the Government was considering whether the traditional attitude to carriage of arms by members of the Women's Services should be revised. Mr Pym has asked me to let you know that he plans to make an announcement on this next Monday in answer to a written Parliamentary Question. I attach a copy of the Question and the proposed Answer.

27/11

I am copying this letter to Richard Prescott (Paymaster General's Office), Murdo MacLean (Chief Whip's Office) and to David Wright (Cabinet Office).

*Your sincerely
John Dawson*

(J D S DAWSON)

N J Sanders Esq



To ask the Secretary of State for Defence what representation he has received about the proposal that servicewomen should be allowed to bear arms, and if he will make a statement.

A N S W E R

(Mr Francis Pym)

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There is no requirement at present for the WRNS to carry arms; and there is no question of members of any of the Women's services serving in a combat role.

REC Gatt rules
Naval purchasing
Defence

MINISTRY OF DEFENCE WHITEHALL LONDON SW1A 2HD

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

M.H.
26x.

MO 26/2

25th November 1980

Dear Christopher,

Thank you for your letter of 11th November.

We had been planning for all the four contracts you mention to be placed before the end of 1980 and funds were earmarked for that purpose. Although there would be no expenditure in the current year, they would involve significant expenditure in 1981/82 and I cannot yet say whether the reduced defence budget will be able to accommodate them.

I will write to you again as soon as possible.

I am sending a copy of this to the Prime Minister and the Chancellor of the Exchequer; and to Sir Robert Armstrong.

Francis Pym
Francis

Francis Pym

The Rt Hon The Lord Soames GCMG GCVO CH CBE

CONFIDENTIAL



Defence

10 DOWNING STREET

From the Principal Private Secretary

SIR ROBERT ARMSTRONG

DEFENCE EXPENDITURE

I have shown the Prime Minister your minute A03584 of 17 November 1980.

She has taken note of your exchange with Mr. Aaron on the question of UK defence expenditure.

RAW.

18 November 1980

CONFIDENTIAL

Original as Public
Expenditure Pr12.



FILE

VLS

7

→ Defence Budget Pr14

10 DOWNING STREET

CC HO
FCO
LPO
HMT
CO

From the Principal Private Secretary

18 November 1980

Dear Brian,

Public Expenditure: Defence Budget

The Prime Minister and your Secretary of State met this evening to discuss the future level of the defence budget in the context of the review of public expenditure which the Cabinet will resume at its meeting tomorrow.

They agreed that the defence budget for 1981/82 should be reduced by £200 million at late 1979 prices, subject to the following conditions:

- (i) In accordance with agreed cash limits policy and with the treatment of overspends on the defence cash limits in 1978/79 and 1979/80, any overspend on the 1980/81 defence limit would require a compensating deduction from the limit for 1981/82.
- (ii) If the decisions taken by the Government in the light of the recommendations of the Armed Forces Pay Review Body entail an increase in the Armed Forces' pay bill beyond the 6 per cent already provided in the defence cash limit, the cash limits will be increased by the full amount involved.
- (iii) The prices factor for the cash limit on defence budget expenditure other than pay will be 11 per cent, but in recognition of the special considerations affecting price increases in this programme the limit will be subject to review in the light of changing circumstances.

SECRET

/ (iv)

(iv) The Government adheres to its commitment to NATO to increase defence spending in real terms by 3 per cent a year, economic circumstances permitting, and trusts that economic circumstances will permit the United Kingdom to resume this rate of growth in 1982/83 and later years.

The Prime Minister and Mr. Pym agreed that these decisions should be reported to Cabinet tomorrow morning. I have already conveyed them to the Chancellor of the Exchequer.

The Defence Secretary told the Prime Minister that he would now need to consider the implications for the defence programme of the reduction of £200 million in next year's defence budget. He said that he would probably wish to bring to OD in due course his proposals for adjusting his programme: these might include a recommendation that there should be a review of our defence commitments.

I am sending copies of this letter to John Halliday (Home Office), George Walden (FCO), John Wiggins (HM Treasury), Jim Buckley (Lord President's Office) and David Wright (Cabinet Office).

Yours now,

John Wiggins.

B. M. Norbury, Esq.,
Ministry of Defence.

99



Comm. Minutes

Ref: A03584

ML

MR WHITMORE

17xi

cc Mr Ibbs
Mr Le Cheminant
Mr Wade-Gery

MW

Defence Expenditure

Mr Aaron, who is Dr Brzezinski's principal lieutenant on the staff of the National Security Council at the White House, has been in London, and Mr Wade-Gery and I saw him today.

2. Mr Aaron asked whether, in the course of the current public expenditure review, the Cabinet would be able to agree on a figure for defence spending which was consistent with the NATO commitment of 3 per cent a year growth in real terms. He left us in no doubt that, if we failed to do so, there would be an adverse effect on United States public opinion in its present state of feeling that Europe should be doing more and not less, and we could have trouble with the new Congress and perhaps with the new Administration, though they would no doubt be understanding. We should be reminded of the commitment in the exchange of letters about Trident to the "reinforcement" of our conventional capability.

3. I said that the review of public expenditure was still in train, and I could not say what the outcome would be. I went on to assure him that the Government was well aware of that aspect of the matter, and [relying on the knowledge that a reduction of £250 million would still mean an increase of over 2 per cent in 1981-82], I expressed the hope and belief that our performance would compare favourably with that of other members of the alliance.

RA

ROBERT ARMSTRONG

17 November 1980



PA.

hw

1980

Ref. A03584

MR. WHITMORE

Defence Expenditure

As far as I can discover, the present positions are as follows.

2. The Chancellor of the Exchequer's latest paper for Cabinet continues to be drafted in terms of a reduction of £500 million. At the meeting of Cabinet on Wednesday, he will talk about £300 million; but he will be prepared to come down to £250 million for a settlement.

3. The Secretary of State for Defence will stick to his figure of £152 million. He will be prepared to come up to £188 million, provided that he gets satisfactory formulae on his three conditions. No doubt he would round that up to £200 million for a settlement. I do not know whether Lord Soames and Mr. Whitelaw have succeeded in shifting him any further.

4. As to the conditions, I attach herewith possible formulae. For each of Mr. Pym's three conditions I have shown first, as i., a formula which would satisfy Mr. Pym; and second, as ii., a formula which would satisfy the Chancellor. I have also included, as an indispensable element, Mr. Pym's willingness to absorb next year this year's overspend. This is getting bigger every day: it is now somewhere between £250 million and £350 million.

5. I believe that Treasury officials would advise the Chancellor that he could in the end settle for the first-formula (the one preferred by the Secretary of State for Defence), ^{on all three} if that helped to reach agreement on a higher figure.

6. If my information is right, the Secretary of State for Defence's agreement on a figure will be conditional upon agreement upon formulae. It looks as if this will all need to be put together in a meeting between the Prime Minister, the Chancellor and the Secretary of State for Defence some time between now and Wednesday's meeting of the Cabinet. I do not think that there is now any more that officials or other Ministers can do.

ROBERT ARMSTRONG

(drafted by Sir R. Armstrong and signed on his behalf)

17th November, 1980

1200 -

1. i. It is agreed that if the decisions taken by the Government in the light of the recommendations of the Armed Forces Pay Review Body entail an increase in the Armed Forces Pay Bill beyond the 6% already provided in the Defence cash limit, the cash limits will be increased by the full amount involved.

ii. It is agreed that if the decisions taken by the Government in the light of the recommendations of the Armed Forces Pay Review Body entail an increase in the Armed Forces Pay Bill beyond the 6% already provided in the Defence cash limit, the cash limit will be increased by 25% [or some other proportion] of the excess, or by £50 million, whichever ever is the less.

2. i. The prices factor for the cash limit on defence budget expenditure other than pay will be 11%, but in recognition of the special considerations affecting price increases in this programme the limit will be subject to review in the light of changing circumstances.

ii. If inflation proves significantly higher or lower than expected when the factors were determined, the Government may, in accordance with established cash limits policy, decide to hold a general review of all limits, including defence.

3. i. The increase in defence spending in real terms between 1980-81 and 1981-82 following the Cabinet's decisions is forecast as $\left[\quad \right] 7\%$. Real spending on defence increased at an annual rate of 3% in 1979-80 and 1980-81, and it is the Government's firm intention to resume annual growth of 3% in real terms in 1982-83 and later years over the 1981-82 figure as now determined.

ii. The Government adheres to its commitment to ~~NATO~~ to increase ~~defence~~ spending in real terms by 3% a year, economic circumstances permitting, and trusts that economic circumstances will permit the United Kingdom to resume this rate of growth in 1982-83 and later years.

4. Agreed

In accordance with agreed cash limits policy, and the treatment of overspends on the defence cash limits in 1978-79 and 1979-80, an overspend on the 1980-81 limit would require a compensating deduction from the defence 1981-82 limit.



MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1
 Telephone 0179307022 218 2111/3

MO 8/2/12

17th November 1980

Tim
Not really
very informative
when you study it!
 Dear Tim,

Am this

mod's reports about
defence contracting.

THE DEFENCE PROGRAMME 1980/81

Thank you for your letter of 3rd November.

Frank A

Although your letter does not call for a reply, my Secretary of State thought that it might be helpful to have on record a note about our attitude to non-competitive contracts, particularly given the complaints at the moment from industrialists that they are earning too low a real rate of return on Government work.

R
21/11

Free market forces as we would normally understand them do not operate in the customary way over most of the defence industries: the industrial base is simply too small, and our resources too limited, to allow for significant domestic competition on the major areas of our business. This is not a situation unique to Britain and even the United States is finding it increasingly difficult to award contracts for major systems on a competitive basis.

Our approach to this basic problem is to seek to simulate competitive pressures through providing contractors with worthwhile incentives to carry out the work efficiently and to time, whilst at the same time to expose them to the risk of a loss, or of a reduced profit, should efficiency and cost consciousness fall short.

The fact that often we are a monopsonist facing a monopoly supplier does not mean that we simply pay up on a cost-plus basis. Three quarters (by value) of our non-competitive contracts are in fact concluded on some kind of incentive basis, the vast majority being tied to either a fixed or a maximum price. We resort to cost-plus contracts only for work for which definitive specifications

T P Lankester Esq



cannot be provided in advance - such as research and study contracts and some development work. However, even in those cases part of the profit takes the form of an efficiency allowance (currently up to 3% on costs). Our aim is to increase further the proportion of contracts negotiated on an incentive basis and to achieve earlier pricing so that we can switch at the first sensible moment on any project to an incentive contract.

In addition to the Public Accounts Committee, which keeps a careful eye on our pricing arrangements, there is also an independent Review Board for Government Contracts. This Board was set up in 1968 following the Ferranti and Bristol-Siddeley scandals, when it was found that we had paid unreasonably high prices. Perhaps I can draw to your attention the attached copy of the recently published Third General Review by the Board, which is still under consideration by the Financial Secretary to the Treasury, and which shows that defence contracts do not represent easy pickings for industry. You will see that the average return for 49 contractors whom the Board consulted was nearly 2% below the intended return. Industry is currently arguing that profits for non-competitive work are likely to be quite inadequate to permit investment and maintain viability should the Government adopt the recommendation of the Review Board not to disturb the present target rate.

Yours ever,

(D B OMAND)

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Review Board for Government Contracts: Report on the Third General Review of the profit formula for non-competitive government contracts.

Published by HMSO, August 1980 [ISBN 0 11 630292 5]

Signed Wayland Date 26 July 2011

PREM Records Team

Defence

Ref: A03584

MR WHITMORE

cc Mr Ibbs
Mr Le Cheminant
Mr Wade-Gery

Defence Expenditure

Mr Aaron, who is Dr Brzezinski's principal lieutenant on the staff of the National Security Council at the White House, has been in London, and Mr Wade-Gery and I saw him today.

2. Mr Aaron asked whether, in the course of the current public expenditure review, the Cabinet would be able to agree on a figure for defence spending which was consistent with the NATO commitment of 3 per cent a year growth in real terms. He left us in no doubt that, if we failed to do so, there would be an adverse effect on United States public opinion in its present state of feeling that Europe should be doing more and not less, and we could have trouble with the new Congress and perhaps with the new Administration, though they would no doubt be understanding. We should be reminded of the commitment in the exchange of letters about Trident to the "reinforcement" of our conventional capability.

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ROBERT ARMSTRONG

ROBERT ARMSTRONG

17 November 1980

SECRET



Defence

or Minister

SUBJECT

10 DOWNING STREET

From the Principal Private Secretary

13 November 1980

Dear Brian,

Defence Expenditure

The Secretary of State for Defence brought the Chiefs of Staff to see the Prime Minister yesterday afternoon so that they could let her know their views on defence expenditure.

The Chief of the Defence Staff said that he and his colleagues were grateful to the Prime Minister for agreeing to see them. They did not want to add to her burdens but they were very concerned about the country's declining military capability. Our operational capability was determined by the Soviet threat and by the Government's commitments. But the Chiefs of Staff thought that a dangerous divergence was developing between what was required and what could be provided with the resources available. OD had agreed in July on a re-shaped defence programme which would reduce our operational capability across a wide field. The decisions which Ministers had taken would reduce the base line of the defence programme, and at the same time the acquisition of Trident had to be accommodated within the money available, for this programme had not been previously allowed for within the defence programme. He had told OD at that time that the prudent limit of the defence programme had now been reached, and that had been on the assumption that an appropriate level of defence expenditure would be available. Since then the world had become a more dangerous place. Moreover, the defence programme had come up against the difficulties imposed by the cash limit. The Ministry of Defence had taken emergency measures to restrain its spending. There had been the moratorium on equipment contracts; all new works service had been stopped; recruitment to the forces had been reined back; and in order to save fuel there had been a 30% cut-back in activity and war reserves had been depleted. These steps were unprecedented since the War. It would, however, be possible to recover from them provided they were short term measures only. But if defence expenditure was to be cut in 1981/82 and similar measures became necessary, the programme could become unmanageable and it might not be possible eventually to recover. The Chiefs of Staff were worried that next year's cash limit would be too small and that whatever pay award the Services received would have to be accommodated within it.

/The CDS

SECRET

SECRET

- 2 -

The CDS continued that it was important to understand the long term nature of the defence programme. Expenditure was committed far in advance, and this left little flexibility in the early years. Nine-tenths of the defence budget for any particular year was committed at the outset of that year: in today's terms, this meant that roughly £1 billion was uncommitted, but half of that was needed for unavoidable expenditure on things like fuel and food. This was a measure of how difficult it would be to accommodate the cut in the base line for 1981/82 which the Treasury were seeking. Moreover, a cut of £188 million next year represented a reduction of £2 billion over the 10 year programme; this was the equivalent of half the cost of Trident or the cost of two major projects. It would require a fundamental re-shaping of the defence programme. The Services would not be able to meet their commitments with a capability which Chiefs of Staff judged to be sufficient. They would be facing the forces of the Warsaw Pact with inadequate equipment. The nuclear threshold, which was already low, would come down still further. If the proposed cuts were made the Government would have a choice between running a risk which, in the view of the Chiefs of Staff, would be dangerous and cutting the commitments which the Armed Forces now fulfilled.

The Chief of the Air Staff said that he could best exemplify the effect of present and proposed cuts on the RAF's capability by looking at the air defence of the United Kingdom. The Soviet air threat against the UK was estimated to be made up of 250 bombers or more. At the moment we could muster about 100 fighters in response. Last year the Government had decided on some interim improvements, including an additional Lightning Squadron and running on three Phantom Squadrons, until the Tornado ADV came into service. An annual increase in expenditure of 3% would allow these improvements to be made and the number of aircraft to be built up to the 150 which were assessed to be necessary to do the job. These plans had had to be trimmed back in the light of OD's decisions in July. Further cuts now would mean that the plans to form the Lightning Squadron would have to be dropped and the Shackleton Airborne Early Warning Squadron would have to be disbanded early leaving a three year gap in AEW cover until the introduction of the Nimrod. These measures, together with others, would leave the air defence of the UK in a worse state than it had been when the Government came into power. It was not possible to improve our capability in this field by transferring resources from elsewhere. The transport force, which was at half the level of five years ago, was now at the minimum required to meet its war role and to provide an out of area capability. The Nimrod surveillance force was at the lowest possible level at which an adequate check of Soviet activity in the Eastern Atlantic could be made, and our tactical air capability was already below its planned numbers. If further cuts in expenditure were made, we could be prejudicing the ability of the RAF's air crews to carry out the tasks laid upon them.

/The Chief of the Naval

SECRET

SECRET

- 3 -

The Chief of the Naval Staff said that even the measures to achieve the expenditure targets in the 1980 White Paper would cause severe damage to the present and future capability of the Fleet. Moreover, the naval programme would be cut by £1.3 billion as a result of OD's decisions in July. This meant that by the end of the next financial year planned orders for one nuclear submarine, four frigates, 15 mine sweepers and 30 aircraft would not be placed; and no major surface warship would be ordered in the first three years of this administration, something which was unprecedented in the recent past. The implications for the Navy's industrial base were very serious. It was possible that three shipyards would have to close, with the loss of 15,000 jobs in the ship building industry and three or four times that number in ancillary industries. There had already been a 30% cut in the Fleet's activity this year in order to save expenditure on fuel. All these steps meant that the Fleet's ability to do its job had already been severely reduced. If there were more cuts in 1981/82, the fighting efficiency of the Navy would be lowered still further. A cruiser, a destroyer and two frigates would have to be sold or scrapped, and one Royal Marine Commando disbanded. There would have to be further reductions in orders for new ships. Our force declarations to NATO would have to be revised; and this at a time when the Alliance was calling for an increased naval effort. The Soviet Union was building three new classes of nuclear submarines, with one submarine being completed every eight weeks, and four new classes of surface warship. In his professional judgement the cuts which the Navy were being forced to make would prejudice the adequate security of the United Kingdom for a long time.

The Chief of General Staff said that he had been trying to improve what he called the staying power of the Army. The role of BAOR, with our allies, was to win any war in Europe or if that were impossible, to create a breathing space in which Governments could take decisions about the use of nuclear weapons. In May 1979 our forces in Germany had been capable of intensive fighting for only 4-5 days. The aim had been to increase this period to 8-10 days. But, following OD's decisions in the summer, the core of the Army's equipment programme would have to be cut, and it would not be possible now to improve on the period of 4-5 days.

The CGS continued that he was also concerned about the quality of the Army's equipment. The growing sophistication of Soviet weapons could not be ignored, and we had to match it to an extent if we were to survive. Already there had been cuts - for example, in night vision equipment, our long-range target acquisition capability and in the Rapier programme - and if expenditure were reduced again, there would have to be further cuts which would mean that the Army simply did not have the equipment to do the job. Moreover, combat units would have to be disbanded, and it would be impossible to meet existing commitments, let alone any new ones. Training would have to be continued at the restricted level which had applied during the last few months. These measures would be seen by the Army as a volte-face in policy, and morale would inevitably be affected.

/The Secretary of State

SECRET

The Secretary of State for Defence said that an annual increase of 3% in real terms sounded good but it was actually a negative figure because real costs of equipment were growing all the time with increased sophistication. Nonetheless, in the light of the general economic situation, he had accepted a smaller increase in the cash limit for this year than was strictly required. He had now offered, in the present review of public expenditure, a reduction of £152 million in the planned defence budget for 1981/82, subject to certain conditions. As he had made clear to the Cabinet, the Chiefs of Staff did not recommend this reduction: on the contrary, they believed that the defence budget should not be reduced at all.

The Prime Minister said that she would like to spend as much as possible on defence, but the fact was that she could not ignore the overall economic state of the country. We were now in a very deep recession which was world-wide and OPEC-induced. Our allies were also affected, and a number of them were reviewing their own defence programmes. The FRG, which was in the front line, was expecting to increase its defence budget this year by only 1.7%. We were now facing a PSBR of between £11 and £13 billion next year. Financing a borrowing requirement of this size was bound to keep up interest rates, and this would place an enormous burden on industry. This was why it was essential to keep public expenditure totals to those published in the White Paper of March of last year. Even so, she accepted that in the judgement which Ministers had to make about where reductions in public expenditure should fall in order to accommodate excesses in other programmes, defence should continue to have some priority. Last year, defence expenditure had shown an increase of 3%. If the defence budget was overspent this year by £70 million - and although she did not wish to encourage overspending all the signs were that the defence excess would be over this sum - the increase would again be about 3%. This was better treatment than other programmes had received. Next year the defence budget would be of the order of £10 billion. She accepted that a reduction of £500 million or even £400 million was not attainable. But she believed that a reduction of £250 million should be possible. This was only £60 million more than the saving which would be produced by the application of the 2% volume cut to cash limited programmes which other Departments were accepting. A reduction of this size was very small in relation to the total size of the defence budget, particularly coming after two annual increases of 3 per cent. She did not believe that a cut of this order would materially affect the Soviet Union's assessment of the defence capability of the United Kingdom and, much less, of the capability of the Alliance as a whole. Even with a cut of £250 million, defence spending would still rise by 1.9%. She understood the desire of the Chiefs of Staff for a stable base-line on which to plan their programme, but she could not say what resources would be available over ten years, any more than the Chiefs of Staff could say where the forces would be deployed in 1990. The fact was that in today's economic circumstances no programme could be allowed to have its volume regardless

/of cost.

of cost. In any case, an approach of that kind would provide no incentive to efficiency. Firms in the private sector were cutting costs very hard and she believed that there was scope for similar action in defence establishments like the dockyards. She was, however, prepared to accept that the MOD should not have to find the entire Armed Forces pay increase due next April from within whatever cash limit was applied to the programme as a whole.

The CDS said that the Chiefs of Staff understood the international and national problems facing the Government, not least its economic difficulties. He acknowledged that the Government could spend on defence only what the country would bear. But the job of the Chiefs of Staff was to report to the Prime Minister what defence capability the available resources would provide. They believed that if the defence programme approved by OD in July was to be carried through, there should be no reduction at all in the levels of defence expenditure announced in the spring. This year's overspending was due to faster billing by industry than had ever been known before and to a cash limit which was unrealistically low in relation to inflation in the defence field. If next year's cash limit was also set too low and if the MOD had to absorb all or even part of the Forces pay increase, the programme would have to be reined back to avoid an overspend. In addition there was now the prospect of cuts in defence expenditure as part of the current review of public expenditure. A cut of £250million next year would be £2.5 billion over the 10 year defence programme, and this would mean projects and men would have to go. The tail had already been cut back over the last decade and efficiency generally was high: there was little scope for savings in this area. The decision on the allocation of resources was of course entirely a matter for Ministers. The Chiefs of Staff were simply saying that if planned defence expenditure had to be reduced, they wanted their commitments cut. They would then reshape the defence programme accordingly. Anything less was not fair on the Forces. Servicemen should not be asked to carry out commitments with inadequate resources. It was not for the Chiefs of Staff to recommend which commitments should be given up: that was for the FCO, but they would be ready of course to give their professional military advice in any review of commitments. But the Chiefs of Staff had to warn Ministers that any move in this direction would have serious implications for the cohesion of the Alliance. The United States were calling for a bigger increase in defence spending than 3% per annum and wanted their European allies to do more outside the NATO area. The Europeans were unlikely to agree to this. If the UK, which had hitherto been giving a lead to the Alliance in improving its defence effort, then reduced its commitments, the United States might well decide to do less in Europe. This could lead to decoupling and eventually to the disintegration of NATO.

The CAS said that the planned budget for the RAF for 1981/82 had originally been £2954 million. Following OD's decisions this had been reduced to £2878 million. When committed expenditure on things like pay and pensions was allowed for, there was less than £200 million to play with. It was, of course, possible to cancel existing contracts, but any savings would be offset by the payment of cancellation charges.

/The CGS said

SECRET

- 6 -

The CGS said that to argue that a defence budget of £10 billion should have no difficulty in finding economies of only £60 million was to overlook two important points. First, as the CDS had made clear, the savings in one year would be extended over future years, so that what appeared to be a small cut was in fact a major reduction in the defence programme. Second, savings in the short term had to be found from the relatively small sums of uncommitted money and this inevitably meant that measures had to be taken which made little sense when seen against a longer time-scale and which could severely damage the Forces' capability. It should be borne in mind that the Chiefs of Staff had said that they would give Trident high priority within the defence programme on the basis that our conventional capability would not be affected as a result. But cuts of the size now under discussion would undoubtedly affect the conventional capability.

The CDS thanked the Prime Minister for giving him and his colleagues the opportunity to set out their views so fully. He repeated that their advice had to be that there should be no further reductions in planned defence expenditure. But if Ministers decided that there should be such cuts, the Chiefs of Staff felt that there should be a corresponding reduction in commitments. They had found the discussion with the Prime Minister very valuable and they hoped that she would be ready to see them informally from time to time.

The Prime Minister said that she was grateful for the advice of the Chiefs of Staff. She would consider it further in the context of the wider economic situation of the country. She would be very ready to meet the Chiefs of Staff in future, as the CDS had proposed.

I should be grateful if this letter could be circulated within the Ministry of Defence only to those who have a strict need to see it. I am sending copies of it only to John Halliday (Home Office), George Walden (FCO), John Wiggins (Treasury) and David Wright (Cabinet Office), and they too should similarly restrict its further circulation.

Yours ever,

Oliver Whittaker.

B.M. Norbury, Esq.,
Ministry of Defence.

SECRET

MEM

NBPM YLE MAD

Civil Service Department,
Whitehall,
London, SW1A 2AZ

With the Compliments
of the
Lord President of the Council



Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

11 November 1980

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

Dear Francis,

One of the effects of the new EC and GATT rules about public purchasing is that we must complete any single tender contracts before the end of the year, wherever we can. There are four Ministry of Defence contracts which could be signed now, but for your moratorium on capital expenditure. They are the three contracts for computers at the Naval Dockyards at Chatham, Devonport and Rosyth and one for communications equipment for CRISP.

I gather that your recent relaxation of this moratorium will not automatically enable these to be signed. But if they are not, the contracts could be open to challenge because they have not been advertised in accordance with the new rules. By far the simplest solution would be to complete the contracts before the end of the year, and I hope you will find it possible to give the necessary authority to your people to do so.

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

Yours ever

Christopher

SOAMES



Defence

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

11th November 1980

T.P. Lankester Esq.
Private Secretary
10 Downing Street
LONDON
SW1

Dear Tim,

DEFENCE EXPENDITURE: GERMAN PLANS IN RELATION TO THE NATO
3% TARGET

With my letter of 17 October under the heading of "Public Expenditure and the BAe flotation", I enclosed a note about the performance of other countries in relation to the NATO target.

We were not at that time able to say anything about Germany's future plans. You will have seen reports in the past week (Times, 4 November) that the Germans have decided that they can afford only 1.75 per cent growth next year. The Federal Chancellor is reported (Times, 8 November) as defending that decision with the suggestion that NATO's aim of a 3 per cent increase should be looked at again in the light of what promises to be a prolonged slow-down in the growth rate of Western countries. Both he and the Finance Minister, Herr-Matthoefer, argued that the crude expenditure figures were a poor way to measure a country's contribution to the Alliance.

The Chancellor would be grateful if you would check that these reports have not escaped the Prime Minister's attention.

I am sending copies of this letter to the Private Secretaries to the Home Secretary, the Foreign and Commonwealth Secretary, the Defence Secretary, the Lord President and the Chief Whip; and to Sir Robert Armstrong.

Yours

John

A.J. WIGGINS
Private Secretary



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

11 November 1980

Tim Lankester Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Tim,

DEFENCE EXPENDITURE

... The Prime Minister is to meet the Defence Secretary and the Chiefs of Staff at 4.30 p.m. tomorrow. I attach some briefing which she may find useful for that meeting and also, perhaps, for subsequent Ministerial discussions leading to the settlement of the Survey issue.

We have prepared it in the form of short one- or two-page notes and tables as follows:

- A: The defence programme: the key figures.
- B: The need to prune growth of the defence programme in 1981/82 (a speaking note).
- C: Arguments the Chiefs of Staff may use, and counter-arguments (a Defensive brief).
- D: Performance of other countries in relation to the NATO target (a background note).
- E: Conditions for agreement on the size of the Defence Budget (this note will be more relevant to the subsequent Ministerial discussions).
- F: Prospective overspending of the Defence cash limit for the current year (a background note).

The Chancellor has asked me to say that his strong view is that Defence should be pressed to accept a reduction of £300 million in 1981/82. As for the four conditions

/previously mentioned

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previously mentioned by the Defence Secretary [Annex E], all cause the Chancellor difficulty, but he would, in the context of a reduction of some £300 million, be prepared to contemplate a concession on a partial cash limit adjustment for Armed Forces pay. But these points would not, I imagine, arise during tomorrow's meeting.

Yours

John

A J WIGGINS
Principal Private Secretary

CONQUEROR

Annex ADEFENCE PROGRAMME

	<u>£m 1980 Survey prices</u>	<u>% increase</u> +
1. Actual outturn 1979/80	9292	3.0
2. Forecast outturn 1980/81	<u>9510*</u> ^{80.}	2.3.. 37
3. Survey baseline 1981/82	9942	4.5 →
4. Original Treasury bid 1981/82 (-400)	9542	0.3
5. Latest Treasury bid 1981/82 (-500)**	9442	-0.7
6. Defence Secretary's proposal 1981/82 (-152)	9790	3.0
Possible Compromises 1981/82		
7. i. (-300)	9642	1.4
8. ii. (-250)	9692	1.9

* Current estimate of outturn consistent with the cash limit. If MOD exceed the cash limit the volume outturn will be correspondingly higher. For example 3% growth would imply an overspend of £70m (cash) and reduce the increase implied in item 8 to 1.3%. The overspend is likely to be more than £70m.

** The proposed deduction was reduced from £600m (total of previously proposed reductions + 2% volume cut) to £500m in recognition of particular Defence problems.

+ Items 4 to 8 all assume full 3% growth in 1982/83 and 1983/84.

THE NEED TO PRUNE GROWTH IN DEFENCE SPENDING IN 1981-82

The containment of public expenditure is an essential element in the Government's economic strategy. The PSBR must be held to a manageable level if interest rates, which are currently such a severe burden on industry, are to be reduced. Such are the pressures on the PSBR now from the nationalised industries and from the social security programme that very substantial cuts are inescapable. The alternative of increasing taxation would be a second best course, but even that cannot be excluded.

2. The scope for savings on other programmes is severely limited: indeed there are some areas such as special employment measures, where increases are being sought. Defence represents a sixth of all central Government expenditure, or a quarter if one excludes the social security programme. Last year we cut total public expenditure programmes for 1981-82 by £6.3 billion or 8.4%, while Defence was allowed to increase. The planning figure (Cmnd 7841) for 1981-82 would now represent a 5.7% increase on the volume for 1980-81 which was implicit in the decision on the August cash limit increase.

3. It has become impossible to reconcile this rate of growth with the progressive decline in output (5% taking this year and next together). The Defence Secretary accepted in the August discussions on the cash limit that it was necessary to fall short of the NATO target in the short term in the interests of restoring the economic health which will sustain an enhanced Defence effort in the future.

4. The success of the overall public expenditure strategy, which will require great sacrifices from other Ministers, demands a substantial contribution this time from the previously protected programmes. The Home Secretary has accepted a cut in the provision for law and order.

5. The reductions under discussion by Cabinet are marginal to a programme amounting to well over £10 billion (cash). Nor would they call in question the Government's continuing commitment to plan for 3% growth, since we shall achieve 3% growth this year,* as last year, and - whatever Cabinet decides on 1981-82 - will still be planning for 3% in 1982-83 and 1983-84. Other programmes are planned to decline by 2½% per annum.

*See first footnote to Annex A

ARGUMENTS THE CHIEFS OF STAFF MAY USE

1. The resources presently budgeted are just adequate to support the existing Defence policy. It may be suggested that cuts of £1000 million have already had to be made to get down to the existing expenditure plans (Cmnd 7841).

Answer In Cmnd 7841 the Government announced major increases on the figures published in the previous Government's last White Paper (Cmnd 7439). The only reduction was £65m in 1980-81 MOD used higher figures in their own internal Long Term Costings, but surely the Chiefs cannot have expected to receive a higher allocation of resources under a Labour Government than that which the present Government is providing?

2. It is inappropriate to put a brake on growth in Defence spending while the threat is increasing.

Answer It is up to NATO as a whole to respond to the threat to the Alliance. The UK is carrying a disproportionately heavy share of the burden. The UK is still, along with the USA, well clear of the rest of the field in the share of national income it devotes to Defence (about 5%) and that share will rise as the economy contracts over the next year or so. This compares with other European countries as follows:

	<u>1979</u>
Germany	3.3%
France	4%
Belgium	3.3%
Netherlands	3.3%
Italy	2.3%

The UK's performance in relation to the NATO target will still compare favourably with most of our Allies. The target allows for derogation in the event of economic difficulties, and many Allies have availed themselves of this with less justification than the UK's current circumstances provide. (See Annex D attached.) The Germans, in particular, have never met the 3% target, do not plan to do so next year,

/ and have

and have indeed called into question its appropriateness in current economic circumstances.

The Defence White Paper (April 1980) explained (para 806) that:-

"The Defence programme cannot be insulated from all change, but our aim is to restore its momentum and expand it in the ways we have described. This will mean increased defence spending. But we shall not feel obliged to adhere slavishly to a particular growth path, nor shall we consider it a failure of policy if we modify our spending plans in either direction from year to year as new information becomes available."

3. The cuts would damage Service morale, which has already been adversely affected by the reduced level of activity and delay of certain desirable works programmes in the current year.

Answer This is debateable. Generous pay awards to the Armed Forces have been implemented in full and without staging: recruitment is at a post-conscription peak; and in current circumstances few will be tempted to seek outside employment.

4. The consequences for industry and employment would be severe. Many firms are already in difficulties, and to reduce the level of MOD work by cancelling contracts would mean that some of the firms which form an important part of the Defence industrial base might be forced to go out of business.

Answer Clearly any cuts affecting Defence procurement must have industrial consequences. But the Defence industries would still be faring better than manufacturing industry in general. There is evidence to suggest that the protection which the Defence programme has enjoyed hitherto has been abused, and that firms have taken advantage of it to pass on unjustifiably high pay and price increases.

5. The cuts would cause problems in NATO and especially with the Americans, and would be seen as setting a bad example to the European Allies.

/ Answer

Answer Some UK retrenchment would hardly surprise NATO. Other countries have fallen short of the 3% target with considerably less justification. The UK would still be planning for a rising Defence programme in marked contrast with the steady decline under the previous Administration. After a shortfall in 1981-82, the Treasury proposals would allow for full 3% growth in 1982-83 and 1983-84, as in 1979-80 and probably - given an overspend - this year. The health of the Alliance does give cause for concern, as was recognised in OD Committee last week: the Committee agreed that it would be timely to institute a thorough review of the division of effort within the Alliance and the effectiveness of the way in which that effort was being applied. The Foreign Secretary and Defence Secretary will be initiating bilateral discussions on this subject with the Allies very shortly.

PERFORMANCE OF OTHER COUNTRIES IN RELATION TO THE NATO TARGETThe NATO target

In 1977 NATO Defence Ministers agreed (and their agreement was endorsed at the Washington Summit in May 1978) to aim at making available resources which would allow for annual increases in Defence spending in the region of 3% in real terms, recognising that, for some individual countries, economic circumstances would affect what could be achieved. The agreement covered the period 1979-84. In May 1979 Defence Ministers agreed to extend it to 1986.

The NATO target is not a binding commitment, and there are several ways in which countries can justify deviating from it. It speaks of "increases in the region of 3%", and allows for derogation in the event of economic difficulties. In practice compliance has been very patchy, as the following notes show.

Belgium

The Belgians achieved a 1.7% real increase in 1979, and in 1980 their plans provided for a 1.8% increase in real defence spending. In mid-year they announced a package of emergency cuts designed to save 5% of the Defence Budget in the second half of the calendar year. These measures attracted severe criticism from NATO.

Canada

Canada had negative growth of 2.3% in 1979. In 1980 an increase of 5.2% was planned, followed by 2.6% growth in 1981, but the restrictive fiscal stance being adopted by the Trudeau Administration makes it uncertain whether this will be achieved.

Denmark

Denmark's growth in 1979 was - 0.2% and a further slight decline of 0.7% is planned in 1980. They are now considering a freeze on defence spending at constant prices: the clearest possible departure from the NATO target.

France

France is not a signatory to the target, but in fact French defence spending has been increasing at 3% a year and is likely to continue to do so.

Germany

The Germans achieved 1.7% growth in 1979. Their initial budget for 1980 provided for real growth of 1 $\frac{1}{2}$ %, but supplementary provision is likely to bring them near to 3%: the latest estimate is 2.8%. For 1981-82 it is reported that the government has decided on an increase of 1.75%, and Herr Schmidt has called into question the appropriateness of the 3% target in current economic circumstances.

Italy

Italy achieved 6.0% growth in 1979, but real defence spending is expected to decline by 2.8% in 1980.

Netherlands

The Netherlands achieved 5.0% growth in 1979. Their provisional plans for 1980 showed a real decrease of 2.3% and growth of 2.6% in 1981. The Defence Minister has stated that the country's "difficult financial position" will prevent it meeting the target this year.

Norway

Norway achieved 1.9% growth in 1979 and plans for 2.6% growth in 1980.

Portugal, Turkey

It is accepted that these countries, in their particularly difficult circumstances, will be unable to achieve significant real growth of defence spending in the foreseeable future. Portugal is planning 2% growth in 1980 but negative or zero growth after that.

United States

The USA achieved 3.1% growth in 1979. The budget for fiscal 1980 (ie the year starting in October 1979) was intended to achieve 3.9% growth, although the President did not exempt the Defence Budget from cuts in supplementary provision in the course of the year, so the outturn may be rather lower. The budget for fiscal year 1981 provides for a minimum 2.7% real increase in defence spending, although this is as usual on a conservative assumption about inflation. The plans for future years show increases of more than 4% a year in real terms up to fiscal year 1985.

CONDITIONS FOR AGREEMENT ON THE SIZE OF THE DEFENCE BUDGET

In Cabinet on 4 November Mr Pym made a conditional offer of reductions of £152m a year. He has put no new proposals to Treasury Ministers as he was invited to at that meeting. Treasury Ministers' bid for £500m also still stands, but the Chancellor has indicated that he might be prepared to compromise at £300m. Lord Soames has floated the figure of £250m.

Mr Pym's conditions

2. Mr Pym's offer was subject to four conditions:

(a) while accepting the principle of cash limit deductions to compensate for overspends in preceding years, his willingness to accept a 1981-82 deduction equivalent to the 1980-81 overspend depends on the decisions reached on other issues affecting the 1981-82 limits (see (b) and (c) below);

(b) on Armed Forces pay, Mr Pym seeks agreement that if in due course the Pay Review Body recommends and the Government accept an increase in excess of the amount to be provided in the cash limit, the excess would be financed by an increase in the limit;

(c) on procurement, he argues that as Defence prices rise faster than prices generally the 11% factor will impose an additional volume squeeze, and that either he must now have a higher factor or Ministers must agree that the limit should be subject to review during the year should his forecast prove well-founded;

(d) Mr Pym seeks a guarantee that the programme for the later years will not be further reduced in future Surveys.

Treasury reactions

3. All these create major difficulties:-

(a) no concession can be made on the overspend without compromising cash limit principles. The two previous MOD overspends (1978-79 and 1979-80) were followed by compensating deductions, as is required if the discipline of the limits is to be maintained. And, it is essential at the present juncture to keep up the pressure on MOD to minimise the overspend now threatening.

(b) On Armed Forces pay, there are strong arguments for applying the same restraints as are imposed on the rest of the public

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sector. But the commitment to comparability in respect of Servicemen was a strong and specific one, and there are precedents for treating increases resulting from decisions on AFPRB awards as adjustments to the cash limits. But a full adjustment to the cash limit might amount to some £100/200m (each 1% over the pay factor costs some £25m): a partial adjustment - proportionate or up to money ceiling would be greatly preferable, in that it would impose some discipline on MOD evidence to the AFPRB. If it were now agreed that an adjustment (full or partial) would be made, it would be essential not to publicise this now; the AFPRB must not set economic considerations aside as they might be tempted to do if a blank cheque appeared to be on offer.

(c) On procurement, it would be difficult to concede a special cash limit factor for Defence without opening the door to further similar requests from other programmes. Moreover, MOD have not made out their case for special treatment: the current forecast is for only an insignificant (less than 0.5%) positive relative price effect on Defence procurement in 1981-82. As for the alternative proposal of a mid-year review, the 1980-81 precedent is not encouraging, and suggests that a prior commitment to review creates a presumption of an increase, and so detracts from the discipline on management of the original limit.

(d) Clearly Defence cannot be made immune in future Surveys. Full 3% increases on the reduced 1981-82 figure could be shown for the later years in the White Paper; but would have the same provisional basis as all other later years' figures.

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1980-81 DEFENCE CASH LIMIT

The Defence cash limit was increased by £203m to £10492m in August. This increase followed a review of the cash limit which took into account:

- (a) the additional cost of the Armed Forces pay award (£54m)
- (b) increases in prices above the cash limit factor (estimated at £400m)
- (c) an increase in the volume of the programme caused by the speeding up of Defence work by contractors short of other work, (estimated at £250m)
- (d) a deduction for the 1979-80 cash limit overspend (£50m).

2. It was agreed (i) that the Defence Secretary should eliminate the £250m of volume overspending; (ii) that he should absorb the cash limit squeeze from price increases (£200m) that had been forecast at the time of the Budget; (iii) that the increase should consequently be limited to £203m; and (iv) that there should be no further adjustment to the cash limit.

3. In August the Defence Secretary announced a moratorium on new Defence contracts to last initially for 3 months. It was hoped that this would save £100m. The moratorium was replaced at the beginning of November by a period of "strictest restraint" on Defence contracts.

4. The Defence Secretary has also implemented measures to restrict expenditure on oil purchases, travel and recruitment, and other measures are under consideration.

5. Despite all these measures expenditure has continued at a level implying an overspend of at least £250m. This is a cause for grave concern about which the Chief Secretary wrote to the Defence Secretary (with a copy to the Prime Minister) most recently on 3 November. MOD have not yet supplied the monthly profiles underlying the revised cash limit (requested by the Prime Minister on 10 September): they might help to pinpoint the areas where tighter budgeting is necessary. The Defence Secretary is of course well aware of the gravity of the position.

RESTRICTED

DEFENCE BUDGET - PROPORTION OF UNCOMMITTED EXPENDITURE

at the beginning of the financial year

UNCOMMITTED

FORCES PAY AND ALLOWANCES	2.5% - 65M
FORCES PENSIONS	NIL
CIVILIAN PAY	0.1% - 1M
EQUIPMENT	9% - 475M
MISC	29% - 730M

EXAMPLES OF

UNCOMMITTED EXPENDITURE

EQUIPMENT

SEA SYSTEMS 180M	} SHIPS AIRCRAFT FIGHTING VEHICLES WEAPONS SPARES
LAND SYSTEMS 80M	
AIR SYSTEMS 135M	

MISCELLANEOUS

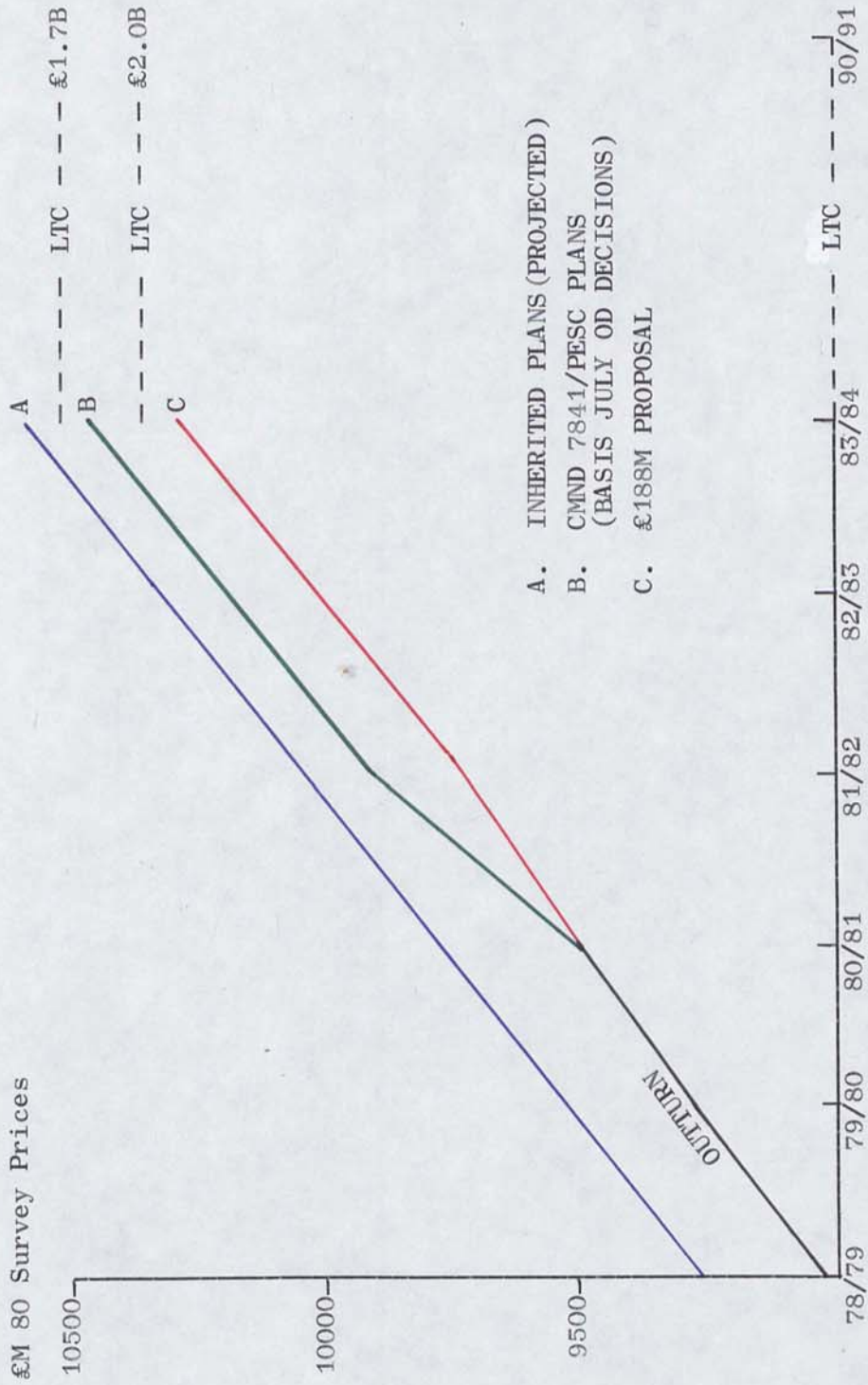
WORKS 210M
FUEL 300M

TOTAL UNCOMMITTED - 1271 M

RESTRICTED

SECRET

DEFENCE BUDGET PROJECTIONS



SECRET



SECRET

3

PRIME MINISTER

Defence Expenditure

We have to consider how to handle this, once you have seen the Chiefs of Staff tomorrow.

2. There are three major questions outstanding:

- (a) The size of the reduction of defence expenditure in 1981-82.
- (b) The treatment of Armed Forces pay for cash limit purposes.
- (c) The application of the prices factor on the cash limit for defence equipment.

3. I now judge that the key to this is the amount: once that is settled it should be possible to resolve the other two questions.

4. I do not believe the amount of the reduction in defence expenditure can be settled except between you, the Chancellor of the Exchequer and the Secretary of State for Defence. It is clear that the Secretary of State for Defence is prepared to move up to £188 million and the Chancellor of the Exchequer is prepared to come down to £250 million. The objective in any meeting between you, the Chancellor and the Secretary of State would be to get the Secretary of State as near as possible to £250 million. I would judge that he might be persuadable to £225 million, subject to a satisfactory agreement on the other two factors.

5. If agreement can be reached on the amount, it would be worth having a preliminary discussion on the other two factors, as a guide to officials to work out some kind of formulation. There will be a trade-off between the two: the Secretary of State for Defence and the Chiefs of Staff would attach more importance to satisfaction on the pay factor than to the prices factor. If the Chancellor were prepared to agree that the cash limit for Armed Forces pay should be adjusted to take account of the Government's decisions following the report of the Armed Forces Pay Review Body, the Secretary of State for Defence would probably be prepared to accept the 11 per cent prices factor, perhaps with some repetition of the general formula - which is already in force in respect of cash limits as a whole - that the cash limit can be looked at again in the event of some major unforeseen change in the relevant considerations.



SECRET

6. If your discussions with the Chancellor and the Secretary of State lead to agreement on the figure and, if possible, some general agreement on the approach to these two issues, officials can be sent away to tie up the words. I should of course be happy to act as a broker in this, if that is what you would like; but it may be your discussions will make that unnecessary and it can be left to the Treasury and the Ministry of Defence to sort it out between them.

7. As to timing, it would obviously be convenient to have the defence figure agreed before Cabinet on Thursday, 13th November, so that you can inform the Cabinet of the outcome. Whatever the outcome was might have a bearing on the reactions of other Ministers on their programmes. But it seems unlikely that the Cabinet will be able to dispose of all the outstanding issues on Thursday, and, if it has not been possible to reach agreement before Thursday, this could probably stand over for further discussions between now and the meeting of the Cabinet scheduled for Wednesday 19th November.

(Robert Armstrong)

10th November 1980



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~230 7032~~ 218 2111/3

MO 25/4/1

10th November 1980

Dear Caroline,

CHIEFS OF STAFF MEETING WITH THE PRIME MINISTER
TUESDAY 11th NOVEMBER AT 11.30

This is to confirm that the names of those who will be accompanying my Secretary of State to the meeting with the Prime Minister at 11.30 tomorrow are:-

Chief of the Defence Staff, Admiral of the Fleet
Sir Terence Lewin GCB MVO DSC

Chief of the Naval Staff, (First Sea Lord)
Admiral Sir Henry Leach GCB ADC

Chief of the General Staff, General Sir Edwin Bramall
GCB OBE MC ADC Gen

Chief of the Air Staff, Air Chief Marshal
Sir Michael Beetham GCB CBE DFC AFC ADC

Yours ever

Susan Ambler-Edwards

(SUSAN AMBLER-EDWARDS)

Miss C M Stephens

cc Mr Lyham



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1
Telephone 01-~~907022~~ 218 2111/3

MO 8/2/12

10th November 1980

Dear Chris,

CALL ON PRIME MINISTER BY THE CHIEFS OF STAFF

We have given a little thought here to what should be said to the press about the call the Chiefs of Staff, accompanied by my Secretary of State, are making on the Prime Minister tomorrow morning at 11.30 am.

We would not propose to volunteer any information about this from here, but I imagine that, in answer to one or two of the Questions on the Order Paper to her tomorrow, the Prime Minister will wish to confirm that, at their request, she has met the Chiefs of Staff to talk about the defence programme. I have sketched out at Annex to this letter some further questions and answers and I should be glad to know whether these are sufficient. We would suggest that any queries are handled by the No 10 Press Office and that our Press Office confines itself to confirming that the Chiefs of Staff saw the Prime Minister, and refuses to be drawn further.

Yours truly,
Brian

(B M NORBURY)

Prime Minister -

This is of course now out of date in part.

Brian and I think there is no alternative but for him to let the lobby know tomorrow morning that the Chiefs of Staff are seeing you. Fred Liming has written along about whether you are meeting him this week. Contact? Agree the notes at Annex? Peter Hill

C A Whitmore Esq

ANNEX

Question

Did they discuss defence expenditure in the next financial year?

Answer

Yes, this was one of the subjects discussed.

Question

Was the meeting arranged because of the leak?

Answer

No. There is no cause and effect between the two.

Question

Is it not unusual for the Chiefs of Staff to have seen the Prime Minister?

Answer

No. The Chiefs of Staff are in regular contact with the Prime Minister.

Question

What decisions were reached at the meeting?

Answer

None. That was not its purpose.

Question

What were the details of the discussion?

Answer

The discussion was confidential as is all advice given by the Chiefs of Staff or officials to Ministers.



1. Mr Mathew

Thanks.

JW

Prime Minister.

10/11

JW

1681

2. For Cals
Folder on
13/11

PRINCIPAL PRIVATE SECRETARY

cc Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Anthony Rawlinson
Mr Bailey
Mr Hansford
Mr Kerr

DEFENCE EXPENDITURE

..... The Chief Secretary would be glad if you would draw the
Chancellor's attention to the attached cutting from the
Times of 4 November about the West German decision to limit
the increase in their defence budget to 1.75 per cent.

TM

T F MATHEWS
6 November 1930

Times 4/11/55

West Germany likely to limit increase in arms budget to 1.75%

From Our Own Correspondent
Bonn, Nov 3

West Germany's coalition parties, the Social Democrats and Free Democrats today ended a week of tough negotiations on a government programme that is expected to include sizable cuts in government spending.

One of the most important victims is West Germany's commitment to Nato to increase its defence spending by 3 per cent in real terms.

The Government of Herr Helmut Schmidt, the Chancellor, now plans to increase its military spending by 1.75 per cent—and that was only achieved after threats by Dr Hans Apel, the Defence Minister, to resign. Herr Hans Matthöfer, the Finance Minister, is reported to have wanted to prune the increase down to 0.2 per cent.

The West German move is unlikely to be popular with its main ally, the United States. Mr Edmund Muskie, the American Secretary of State recently wrote to Herr Hans-Dietrich Genscher, West Germany's Foreign Minister, urging the Government to meet its commitment.

Mr Walter Stoessel, the American Ambassador in Bonn, is due to call on Dr Apel to-

morrow with American demands to spend millions of marks on support facilities—such as the extension and guarding of barracks, stores and depots—for troops which could be flown from the United States to Europe in a crisis.

Failure of this key ally to honour its commitment could psychologically strengthen the position of other Nato members such as Belgium, the Netherlands and Denmark, which have also failed to increase defence spending by 2 per cent.

The United States asked for the increase in order to keep up with the increasing Soviet strength in East Europe.

The programme, to be announced by the Chancellor in Parliament on November 24, is also expected to include cuts in government subsidies.

One of the toughest issues in the negotiations, the Social Democrats' demands for changes in the laws on worker participation on the boards of firms in the mining and steel industries, is still under discussion, after objections by trade union leaders to the Government's proposed stand.

The new Bundestag meets for the first time tomorrow and on Wednesday is expected to re-elect Herr Schmidt as Chancellor.

Please have
this included in
the folder for
Cabinets - and
send copy to
C/Indusgen.

SECRET

2



Prime Minister.

MO 8/2/12

You have already said that you are willing to see the Chiefs of Staff. May I arrange a meeting for next week (though not, of course, on Monday)?

PRIME MINISTER

Yes no

AKH
28

DEFENCE EXPENDITURE 1981/82

I have seen, on my return from this morning's meeting of the Cabinet, the record of discussion on Tuesday.

2. I made it clear on Tuesday, as is recorded, that the Chiefs of Staff could not support the compromise offer on reductions to the defence budget which I made, which is in my judgement absolutely the minimum level which would enable us to say that we were fulfilling our NATO commitment of a 3% real increase next year; I believed, therefore, that it would be premature for the Cabinet to reach any conclusion until the Chiefs of Staff had been able to express their views. What I would now like to suggest is that you should see them with me to enable them to express their judgement of the impact on our defence capabilities of a reduction of expenditure even of the order I proposed, let alone any further reduction; and that, thereafter, I should consider with you the best way forward.

3. I am sending copies of this minute to the Chancellor of the Exchequer and the Chief Secretary; and to Sir Robert Armstrong.

6th November 1980

Ministry of Defence

SECRET

010.

Ref: A03460



SECRET

PRIME MINISTER

Prime Minister.

1

If you are ready to see the
Chief of Staff, Friday would be a
better day than Monday when you will
be encountering very many on the
Hansard House speech. But we should
first need to confirm that X/John is
not held Mr. Pym's position. I could do
this by seeing him before Cabinet tomorrow
if you wish.
R.A.S.

Proposed Reductions in Defence Expenditure

Since the meeting of the Cabinet yesterday, I have been in touch with the Treasury and the Ministry of Defence at top official level.

2. As to the conditions attached to Mr. Pym's offer of £152 million, it should be possible to reach agreement on formulations that are reasonably satisfactory both for the Chancellor of the Exchequer and for the Secretary of State for Defence. Positions are not rigid on either side.

3. As to the amount, the Treasury are clearly prepared to come down to something like £250 million, which would be on top of the overspend from this year which the Secretary of State for Defence has agreed to absorb next year. That could amount to as much as £125 million, over and above the £250 million from whatever cut is agreed.

X

4. The Secretary of State for Defence will be prepared to come up to £188 million. But there are no signs of his being prepared to move further than that, and I judge that he will not do so unless and until you have seen the Chiefs of Staff.

5. The Chief of the Defence Staff will be back in this country tomorrow afternoon. You could see the Chiefs on Friday or on Monday. Thereafter I think that the Secretary of State for Defence may be prepared to move a little further. I would judge that agreement might eventually be reached between £225 million and £250 million.

6. I do not think that any useful purpose would be served by another discussion on defence in Cabinet tomorrow. I suggest that you should simply say that you understand that discussions are still continuing and suggest that the Cabinet return to this programme next week.

(Robert Armstrong)

5th November 1980

SECRET



cc AMT
IND
TRADE
EMP
PSO
W

JH

Defence

10 DOWNING STREET

From the Private Secretary

3 November 1980

Defence Expenditure 1980/81: Contracts
Moratorium

The Prime Minister has read your letter of 30 October and the draft Written Answer which you enclosed with it. As I explained on the telephone, she is content with the substance of the draft, but has queried the need to specify the "essential operational activities" which have not been affected by the moratorium and in particular the reference to the Naval patrol in the Gulf area. You said you would take this latter reference out.

I am sending a copy of this letter to Terry Mathews (HM Treasury), Ian Ellison (Department of Industry), Stuart Hampson (Department of Trade), Richard Dykes (Department of Employment), Richard Prescott (Paymaster General's Office) and David Wright (Cabinet Office).

T. P. LANKESTER

D. B. Omand, Esq.
Ministry of Defence

RESTRICTED

JP

CONFIDENTIAL

3 November 1980

The Defence Programme 1980/81

The Prime Minister has read your letter of 31 October.

You should be aware that she is concerned about the apparent cost-plus basis on which defence contractors are able to recoup their costs whereas manufacturers competing in the market place often have no option but to hold down their prices. Her impression is that defence contractors have been treated far too easily in the past and that your Department could have been much tougher in contract negotiations.

T. P. LANKESTER

D.B. Omand, Esq.,
Ministry of Defence.

12RB
CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Francis Pym MC MP
Secretary of State
Ministry of Defence
Main Building
Whitehall
London SW1A 1HB

2
3/11
3 November 1980

Dear Francis,

DEFENCE CASH LIMITS: 1980-81

I have seen a copy of your minute of 23 October to the Prime Minister.

We must all be concerned at the growing likelihood, despite all that has been said, of a very substantial overspend on your cash limit. The October figures show no sign of any easing in your cash flow: indeed the position seems to be worsening.

I must again ask you to ensure that the further remedial action which you are considering is sufficient to keep within the cash limit at the increased level agreed in August.

It follows that the period which will follow your lifting of the "moratorium" on new contracts must indeed be one of "maximum restraint", with no new flood of pent-up expenditure. I am sure that you have this in mind.

Copies of this letter go to the recipients of yours.

John Biffen

JOHN BIFFEN



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-~~9633000~~ 218 2111/3

MO 8/2/12

31st October 1980

*They have in a different
would be from on which
in detail. How it should
every thing is handled on
a 1980-Plus basis to avoid
the 1981-Plus basis to avoid
the 1981-Plus basis to avoid
the 1981-Plus basis to avoid*

*Answer to questions
you raised on
Mr Pym's minute
(Page A).*

THE DEFENCE PROGRAMME 1980-81

We had a brief word on the telephone about some points arising out of my Secretary of State's minute of 23rd October. *31/10*

I explained that the main difficulty lay on the Defence Vote 2 - which is our main procurement vote - and it is through this vote that our payments are made to industry. The Dockyard Vote 5 also carries expenditure with industry on contract repair on HM ships and some expenditure on plant and machinery, but our current forecast shows that this Vote will not overspend given the stringent conditions now in force for further expenditure from the vote. The position on the Royal Ordnance Factories is that they operate a Trading Fund: we buy equipment from the ROFs and pay the Trading Fund from our Vote 2. We do make progress payments to the Trading Fund (as we would do to any major supplier) but as a result of industrial action (particularly at ROF Bishopton) we have in fact not paid out as much as we had expected.

You drew attention to my Secretary of State's statement (para 7a) about the current rate of inflation on defence goods and services. Our cash limit for our equipment programme was derived from the agreed Treasury re-valuation factor of 14% between the average price levels of 1979/80 and of 1980/81. This was abated for what were then the assumed lags in the presentation and payment of bills, to give an overall inflation allowance of 10.6% on our procurement Vote. Recent discussions with industry suggest that costs in manufacturing have been rising faster than the RPI would indicate. Our own latest

With whom?

*Other manufacturers
1
have never the less had
to keep down prices.*

T P Lankester Esq

*Ms. 7 is not
 being really tough
 enough on
 other side
 cent. i just
 see in their
 case - they
 have to keep cutting
 them to compete.*



measurement of price increases on our procurement vote indicates a 4½% differential over the RPI which is itself about 1½% greater than the original cash limit factor. Applied to the original volume of the Estimates this adds up to £200 million cash squeeze. A further £130 million squeeze has been caused by an inflation rate on general supplies and services (including oil) that is double the original cash limit provision. Savings on the service personnel votes because of favourable exchange rates broadly balance cash deficits in the works, dockyard and other areas so that even with the August cash limit uplift of £150 million there is a residual deficit of some £150M-£200M.

Finally you asked about the rise in industrial overheads which my Secretary of State reported (para 7c). The base of industrial activity over which overhead - or indirect - costs (rent, rates, energy, indirect labour etc) can be spread has reduced temporarily on the civil side. Until economic activity picks up again (or until firms trim their outgoings) the rates of overhead are higher for many firms than otherwise might have been the case. We do face increased costs as a result, although I should emphasise that Ministry prices bear only the share of overhead costs proportionate to the Ministry's own purchases which of course is generally an incentive to firms not to keep on any long term excess of capacity.

Yours ever,

(D B OMAND)

Prime Minister

RESTRICTED

The Treasury are content, does this meet with your approval?



MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1

NA Mitchell Duty Clerk
2/11/80
(For TPL)

Telephone 01-~~5207622~~ 218 2111/3

MO 8/2/12/1

Agree the reply

30th October 1980

with one comment - namely -

do we need to specify the "essential operational activities"? If so they must be chosen very carefully. Northern Ireland in an obvious one

Dear Tim,

DEFENCE EXPENDITURE 1980/81:
CONTRACTS MORATORIUM

but in the second example the best or the only one of importance?

In his minute of 23rd October to the Prime Minister my Secretary of State explained that it would be necessary for us to exercise the severest restraint on new defence commitments for the rest of the financial year. The three month period of the current moratorium expires on 8th November, and my Secretary of State must, therefore, announce very soon what will follow it. My Secretary of State proposes to do this by written answer on Monday 3rd November. I attach a copy of the Answer which he would propose to give. At the same time, we will write to leading industrialists and to representatives of the Employers and Trade Associations with whom we have been discussing the problems encountered this year in regulating the flow of payments from this Ministry to industry.

I am copying this letter and enclosure to Terry Mathews (HM Treasury), Ian Ellison (Department of Industry), Stuart Hampson (Department of Trade), Richard Dykes (Department of Employment), Richard Prescott (Paymaster General's Office) and David Wright (Cabinet Office).

Yours ever,

David Omand

(D B OMAND)

T P Lankester Esq

RESTRICTED

DRAFT

WRITTEN ANSWER ON THE MORATORIUM

The three month moratorium on new defence contracts will end on 8th November.

The moratorium was imposed in order to hold down the rate at which Ministry of Defence entered into new commitments at a time when payments by the Ministry to industry have been running at an unexpectedly high rate.

A number of factors have contributed to the high rate of cash flow on defence contracts so far this year: the sharp change in the economic environment and a shortage of commercial orders have led to faster than expected progress with some defence contracts; industrial overheads have risen and are being reflected in defence bills, some firms are billing faster than normally to improve their cash flow; and the costs of defence equipment have risen faster than expected. The need for urgent action to control costs meant that the moratorium had to be imposed across the board, and the scope for taking account of the circumstances surrounding individual contracts has inevitably been limited, although certain exemptions have been allowed during the period of the moratorium. Essential operational activities, for example in Northern Ireland and the Naval patrol in the Gulf area, have not been affected.

The financial pressures will continue during the remainder of this financial year. The need for strict restraint in defence expenditure including stringent discipline on new commitments therefore remains. But the extension of the moratorium, which I recognise has caused acute difficulties for industry, would not be an appropriate way in which to exercise longer term control. I have therefore instructed my officials in maintaining the necessary restraint to pay particular attention to the industrial, as well as the operational and other, implications.

My Ministerial colleagues in the Ministry of Defence and I will be keeping the working of these arrangements under the closest supervision and the Ministry remains ready to discuss their detailed application with industry. Our aim is to ensure that the purchasing procedures of the Ministry of Defence remain in step with the changing nature of the economic circumstances facing both the Department and our suppliers.



MINISTRY OF DEFENCE
 MAIN BUILDING WHITEHALL LONDON SW1
 Telephone 01-230 7822X 218 2111/3

MO 8/2/12

28th October 1980

Dear Nick,

DEFENCE EXPENDITURE

I will try to answer as briefly as I can the points you put to me on the telephone this morning about the Government's record on defence expenditure so far.

During the past three weeks we have been establishing revised calculations on the volume of defence expenditure in 1979-80 following an agreement of the Appropriation Account figures. The trend has been upwards so we can now expect a defence budget real increase of 2.9% rather than the 2.5% that we were assuming up to a month ago. This merely restores the forecast growth percentage given in the Cmnd 7841.

The figure for the defence programme (ie including ROF repayments) does in fact amount to 3% over the corresponding figure for 1978-79. The figure work is attached (Annex A). It is also relevant that the 1979-80 defence expenditure on NATO definition shows 3% real growth. The Prime Minister can say with confidence therefore that we achieved 3% real growth in defence spending in the Government's first year in office. I also attach a line to take on the justification of the change in the figures (Annex B). NATO uses a standardised definition of defence spending (set out in the attached table - Annex C). Basically NATO definition includes the cost of supporting services such as computers, stationery and accommodation but excludes the cost of the Meteorological Office which we fund on the defence budget.

The NATO 3% aim was last reaffirmed in the 1979 Ministerial Guidance approved by NATO Ministers. The relevant paragraph is at Annex D.

N J Sanders Esq



Finally I should emphasise that when NATO talks of real defence spending they mean what we would call the volume of expenditure. There is no doubt about this. Each of the NATO countries has different national accounting systems but the objective is the same - to remove from the money actually spent that element that corresponds to inflation on the goods and services purchased and wages paid. The defence expenditure figures are reported by all the allies to NATO and are scrutinised by the International Staff to ensure that the figures of defence spending on NATO definition do compare like with like.

Yours ever,

David Omand

(D B OMAND)

ANNEX A

	£M at 1980 Survey Prices	
	<u>1978/79</u>	<u>1979/80</u>
Defence Budget	9037.3 (-)	9296.5 (+2.9%)
ROFs	-11.6	-4.2
Defence Programme	9025.7 (-)	9292.3 (+3.0%)

ADDITIONAL SUPPLEMENTARY NOTE

WHY ARE MOD REVISING 1979/80
EXPENDITURE FIGURES IN
OCTOBER 1980?

All expenditure booked to votes in a given year has to be scrutinised and finally authorised by the Comptroller and Auditor General before the Appropriation Account is finalised. The 1979/80 Appropriation Account figures for defence votes were only recently agreed by C&AG; the cash amounts differed marginally from those submitted from departmental accounts and there have been consequential changes in the underlying volume figures.

Excerpt from *Grant 7826*

Defence budget and related expenditure (1)

TABLE 2.3

£ million

	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81
Defence budget	4,547.5	5,432.4	6,329.9	6,918.8	8,557.7	10,784.5
+ Military aid to overseas countries	1.6	1.9	2.4	2.3	13.6	6.9
Supporting services (2)						
+ Accommodation (maintenance and rental)	38.8	37.5	36.5	47.8	41.9	60.1
Stationery and printing(3)	24.6	33.0	29.6	28.7	32.7	—
Home publicity	4.2	3.6	3.8	4.7	8.6	10.7
Civil superannuation	81.1	96.7	116.7	153.9	181.5	208.3
Computers and telecommunications(3)	9.4	7.3	13.1	14.7	14.4	—
Rates	36.4	48.7	49.9	58.7	64.3	77.9
Services by Exchequer and Audit, etc....	3.1	2.9	3.2	3.3	3.7	4.9
Less cost of						
- Meteorological services in Defence budget	-10.8	-22.0	-20.5	-24.0	-28.9	-36.5
Other adjustments	4.7	-2.2	-5.2	-5.2	-4.2	-4.2
Defence expenditure (NATO definition) (4) ...	4,734.6	5,839.8	6,558.4	7,203.7	8,885.3	11,112.6
US military aircraft loan (net) (5)	-21.7	-7.8	—	—	—	—
Accounting adjustments	3.7	39.2	15.7	9.1	—	—
Defence expenditure (National income definition)	4,716.6	5,871.2	6,574.1	7,212.8	8,885.3	11,112.6

(1) The figures given in the table are based on Estimates and reflect the price levels of the Estimates for the years in question.

(2) These are the defence portion of services performed by certain Government Departments for Government generally.

(3) These items are included in the Defence budget after 1979-83.

(4) The Defence budget figures have to be adjusted as shown to meet the standard NATO definition of defence expenditure. From 1979-80, the standard NATO definition has been changed slightly to agree with the National Accounts definition.

(5) Drawings under the Military Aircraft (Loans) Act, 1986 for the purchase of US military aircraft.

NATO 3% AIM

X-X

The 3% Aim

X/ In the last Ministerial Guidance covering the force goals period 1979-84, [it was decided to aim at making available resources which would allow for annual increases of defence spending in the region of 3% in real terms, recognizing that, for some individual countries, economic circumstances would affect what could be achieved ~~or~~ current force contributions might justify a higher level of increase.] This undertaking was endorsed by Heads of State and Government at the Washington Summit in May 1978. Initial action taken by governments for the achievement of this aim has on the whole been encouraging. In the light of these various factors, nations, over the period of the next series of force goals (1981-1986) should intensify their efforts to implement fully for the whole planning period the resource guidance of 1977.

DEFENCE EXPENDITURE, ADDITIONAL SUPPLEMENTARIES

NOTES FOR SUPPLEMENTARIES

THE DEFENCE SECRETARY SAID THAT THE GOVERNMENT REMAINED COMMITTED TO A 3% INCREASE THIS YEAR, NEXT YEAR AND THE YEAR AFTER. IS THIS TRUE?

3% was achieved last year.

There will be significant further real growth this year.

As for the future the

Government is committed

to the NATO aim for real increase in the region of 3%.

WILL YOU SAY CATEGORICALLY THAT YOU WILL PLAN FOR 3% NEXT YEAR?

As I have told the House

public expenditure plans are

under review in the usual way.

Announcements will be made

in due course.

WHAT RELATION WOULD 3% NEXT YEAR BEAR TO THE CHIEF SECRETARY'S REQUEST FOR A REDUCTION OF £500M

I have nothing further to add.

When we have taken decisions

we will announce them.



Prime Minister

A ~~future~~ note from Mr Pym on what further measures may be needed to stay within the revised cash limit.

MO 8/2/12

PRIME MINISTERTHE DEFENCE PROGRAMME

In my minute of 3rd October I reported the measures I had taken to restrain expenditure in the current financial year within the increased defence cash limit. The Chief Secretary subsequently offered the view, based on the end-September FIS figures, (his letter of 8th October) that I was still on course for an overspend of at least £250m.

?!
? 2. I agree that on present trends an overspend seems very likely. But the situation is difficult to read and a wide range of uncertainty remains. The judgement of the staff responsible for the programme suggests a possible excess lower than £250m. But, as the Chief Secretary says, the rate of presentation of bills continues to be worryingly high. This is an entirely new phenomenon. There is no sign of a falling off yet, but it must fall if expenditure is to be restrained within the cash limit. Because of the lag in presentation and payment of bills, it is not surprising that the drastic cuts I have already made have not produced a downturn in payments yet. I am watching the position with great care.

3. My major difficulty lies with the main procurement Vote. My other Votes are being contained well within their cash limits. Procurement has been particularly hard hit by this year's economic conditions, both the recession and high inflation.

4. If the downturn in payments does not come quickly enough, or is not big enough, to bring expenditure within the cash limit I will have to ration severely the money that goes to industry on existing contracts - this may raise major contractual difficulties - in order to slow down the haemorrhage in our cash flow to industry. In present economic conditions this will create very great difficulties for our suppliers, yet I need their co-operation. Like many other of the measures I have taken its effect will be very visible. Our discussions with industry continue and I shall report further as necessary.



5. But I have also been considering what immediate further cuts in the defence programme are practical possibilities. The room for manoeuvre is now minimal. The initial 3 month period of the moratorium on new defence contracts expires on 8th November. I have decided that it must be discontinued in its present form and replaced by a period of maximum restraint on new commitments. During this period new commitments will continue to be scrutinised individually and allowed to go ahead only if the penalties of cancellation or deferment are disproportionate. But I shall have to allow some exceptions in certain areas, for example, the purchase of stocks and spares, and contract repairs. Otherwise the damage, in the form of shortages, reduced levels of maintenance and loss in the capacity of our forces to operate, will simply be too high. I shall also watch the effect on industry most carefully. In general firms have endured the moratorium so far, but many of the smaller ones will be placed in great difficulty by a longer period of restraint. Many firms, large and small, will have to lay off labour and some may close altogether. There is no avoiding such consequences. But I must try to protect from collapse those firms which are a sole or major source of supply to my Department. If I do not do this, whole capabilities in British industry will disappear and alternatives to foreign purchase will be denied us.

6. I am also considering further cuts in the levels of activity of the armed forces, in addition to those described in my minute of 3rd October. Such cuts would carry very heavy penalties indeed. One option I am having examined is the closure of a number of defence establishments for a period of weeks in order to cut costs. I shall report my conclusions.

The temporary closure of establishments would be unprecedented, and given that the MOD would have to go on paying the staff, I should not have thought that such a step would have produced savings big enough to make the accompanying raw materials...

7. I am very concerned that the quite exceptional difficulties which the defence programme has faced this year should have required me to take, or contemplate, measures of this kind I have described in this minute and my minute of 3rd October. The scale of economies and reductions in the activities of the Armed Forces which I have had to enforce is without precedent known to me, and they run clean contrary to the military need. The cause of our difficulties are:

- a. Inflation has been substantially greater than allowed for in the cash limit.

- Not now
Return limit
3rd month
very substantially
down.

tbl.



b. Some of our suppliers have been making faster progress with their contracts than anything known before and sending in their bills more quickly: this is the direct consequences of the recession and the lack of other work.

c. Industry's overheads in many cases appear to have risen more than could have been forecast. A separate quantitative value cannot readily be assigned to these factors, but I am having further analysis done urgently. If the economic and industrial conditions which have created such difficulty this year were to persist, or even get worse, their continuing effect on my ability to sustain next year a programme which approaches military needs and our international obligations could be very serious indeed, whatever decisions we reach on future volume figures.

8. I am sending copies of this minute to the members of OD, to the Secretaries of State for Industry and Employment, and to Sir Robert Armstrong.

*Are we on
GII plus
contracts?*

Ministry of Defence

23rd October 1980

Original filed
on ECON POL.
Part 3.
Disposal of Public Sector Assets



Prime Minister.
The background to the
British Aerospace issue, on
which Sir Keith Joseph
wants a word next week.

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

MAP 17/x

17 October 1980

T. Lankester, Esq.,
No.10, Downing Street
S.W.1

ml

Dear Tim,

PUBLIC EXPENDITURE AND THE BAE FLOTATION

As you know, Sir Keith Joseph saw the Chancellor this morning to discuss whether the Defence programme could be made exempt from the current public expenditure reductions, and be maintained at the Cmdnd 7841 planned levels, in order at least partially to resolve current uncertainties about future MOD orders for British Aerospace which will otherwise preclude the privatisation of BAe next month. I understand that Sir Keith Joseph may intend to mention the matter to the Prime Minister tomorrow.

The Chancellor explained to Sir Keith Joseph this morning that the level of cuts in total public expenditure which, in his view and that of the Chief Secretary, are now required necessitates a substantial contribution from Defence. While regretting the delay to the privatisation of BAe, he saw no way in which an exemption for MOD could be contrived. At his request, I have subsequently sent to Sir Keith Joseph's office a copy of the attached note by officials which sets out some of the considerations underlying his view that some reductions on the Cmdnd 7841 Defence figures are both essential and defensible within the Alliance.

It may be helpful to set out for your information some figures relevant to the arrangement which Sir Keith Joseph had in mind. As foreshadowed in the Chancellor's minute of 10 October to the Prime Minister, Treasury Ministers are now seeking a substantial reduction, at present set at £500 million pa, in the Defence PES figures throughout

/the Survey

Sir Keith is not
now coming in
on Saturday. We
will get him in
next week.

ML
17x.

.....



the Survey period. To forego any Defence reductions might be to concede rather more than this, since it would be difficult to secure Cabinet agreement to the total public expenditure cuts sought if as significant a programme as Defence had been wholly exempted. On the other side of the equation, the proceeds from a sale in November of 50 per cent of the shares in BAe Ltd. are, on the DOI's estimate, likely to amount to rather less than £70 million; and, provided that no new launch aid proposals from the Company were accepted, the PSBR would additionally benefit to the tune of some £100 million in 1981-82 and £75 million in the following two years as a result of the Company's meeting its forecast capital requirements from within the private sector. The imbalance in these figures is obvious: moreover, it is not certain that a sale of shares next month could take place even if MOD were granted exemption from any Survey reduction, since their current cash limit problems would make it difficult for them to give a commitment to no cancellation of existing BAe orders. Various other uncertainties overhanging the plan for November flotation were mentioned in E(DL) on 14 October.

The picture should of course be much clearer in the New Year.

Yours ever,

Richard Tothick

for

A.J. WIGGINS

NEED FOR CUTS IN PUBLIC EXPENDITURE: WHY DEFENCE CANNOT BE EXEMPT

It is vital to the Government's economic strategy that they should adhere to their commitment to contain public expenditure. It is fundamental to their approach that the size of the public sector should be rolled back. And added to this is a financial imperative to hold the PSBR in 1981-82 to a manageable level. It now appears necessary to find further savings of the order of £2 billion in order to achieve the objective, agreed in July, of holding to the Cmnd 7841 totals adjusted for the EC contribution.

2. The scope for savings on other programmes is severely limited: indeed there are some areas where increases are being sought. Defence represents a sixth of all Central Government expenditure. Total public expenditure programmes for 1981-82 were cut last year by £6.3 billion or 8.4%, while Defence was allowed an increase. Total spending was planned to decline by 0.6% in 1980-81 and 1.2% in 1981-82 while defence was to rise by more than 3% a year. The Cmnd 7841 figure for 1981-82 would now represent a 5.8% increase on the volume for 1980-81 which was implicit in the decision on the August cash limit increase. It has become impossible to reconcile this rate of growth with the progressive decline in output. Mr Pym accepted in the discussions on the cash limit that it was necessary to fall short of the NATO target in the short term in the interests of restoring the economic health which will sustain an enhanced defence effort in the future.

3. The UK's performance in relation to the NATO target will still compare favourably with many of our Allies. The target allows for derogation in the event of economic difficulties and many Allies have availed themselves of this with much less justification than the UK's current circumstances provide. (See the Annex attached, which reflects the position so far as we have been able to ascertain it in consultation with MOD.) The UK is still, along with the USA, well clear of the rest of the field in the share of national income it devotes to defence (about 5%) and that share will rise as the economy contracts over the next year or so. This compares with other European countries as follows:

	<u>1979</u>
Germany	3.3%
France	4.0%
Belgium	3.3%
Netherlands	3.3%
Italy	2.3%

4. It is up to NATO as a whole to respond to the threat to the Alliance. The UK is already carrying a disproportionately heavy share of the burden. Mr Pym recognises this, and is indeed understood to be preparing a paper for OD Committee on the possibility of more equitable burden sharing.

5. Politically, too, the success of the overall public expenditure strategy, which will require great sacrifices from other Ministers, demands a substantial contribution this time from the previously protected programmes. Mr Whitelaw has accepted a cut in the provision for law and order. The whole balance of the package would be distorted if there were no contribution from Defence, and it would not be feasible to re-allocate Defence's share to other programmes.

PERFORMANCE OF OTHER COUNTRIES IN RELATION TO THE NATO TARGET

The NATO target

In 1977 NATO Defence Ministers agreed (and the undertaking was endorsed by Heads of State and Government at the Washington Summit in May 1978) to aim at making available resources which would allow for annual increases in Defence spending in the region of 3% in real terms, recognising that, for some individual countries, economic circumstances would affect what could be achieved. The agreement covered the period 1979-1984. In May 1979 Defence Ministers agreed to extend this objective up to 1986.

2. But it is a target, not a binding commitment, and there are several ways in which countries can justify deviating from it. It speaks of "increases in the region of 3%", and allows for derogation in the event of economic difficulties. In practice compliance has been very patchy, as the following notes show.

Belgium

The Belgians achieved a 4.5% real increase in 1979, but in 1980 their plans provided for a 3.3% fall in real defence spending. In mid-year they announced a package of emergency cuts designed to save 5% of the defence budget in the second half of the calendar year. These measures attracted severe criticism from NATO.

Canada

Canada had negative growth of 2.3% in 1979. The previous Government's plans for 1980 were for an increase of 4.7%, but the restrictive fiscal stance being adopted by the Trudeau Administration makes it likely that the increase will fall well short of 3%; and the prospects for future years are uncertain.

Denmark

Denmark's growth in 1979 was - 0.2% and a further slight decline is planned in 1980. They are now considering a freeze on defence spending at constant prices: the clearest possible departure from the NATO target.

France

France is not a signatory to the target, but in fact French defence spending has been increasing at 3% a year and is likely to continue to do so.

Germany

The Germans achieved 1.7% growth in 1979. Their initial budget for 1980 provided for real growth of only 1½%, but supplementary provision is likely to bring them near to 3%: the latest estimate is 2.8%.

Italy

Italy achieved 6.0% growth in 1979, but real defence spending is expected to decline by 2.8% in 1980.

Netherlands

The Netherlands achieved 3½% growth in 1979. Their plans for 1980 showed a real increase of 2.2% and growth of 1½% in 1981. However the planned 2.2% is unlikely to be achieved because inadequate provision has been made for inflation. The Defence Minister has stated that the country's "difficult financial position" will prevent it meeting the target this year.

Norway

Norway achieved 1.9% growth in 1979 and plans for 2.6% growth in 1980.

Portugal, Turkey

It is accepted that these countries, in their particularly difficult circumstances, will be unable to achieve significant real growth of defence spending in the foreseeable future. Portugal is planning 2% growth in 1980 but negative growth after that.

United States

The USA achieved 3.1% growth in 1979. The budget for fiscal 1980 (ie. the year starting in October 1979) was intended to achieve 3.9% growth, although the President did not exempt the Defence Budget from cuts in supplementary provision in the course of the year, so the outturn may be rather lower. The President's budget for fiscal year 1981 provides for more than a 5% real increase in defence spending, and although this is as usual on a conservative assumption about inflation there seems little doubt that in the current mood the necessary supplementary provision will be granted to achieve most of that growth. The planned minimum growth in 1981 is 2.7%. The plans for future years show increases of more than 4% a year in real terms up to fiscal year 1985. The Presidential candidates are currently outbidding one another on further increases in defence spending - Mr Reagan has mentioned 10%.

PART 3 ends:-

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~~CST to S/5 Defence 8.10.80~~

PART 4 begins:-

HMT to TPL 17.10.80

~~S/5 Defence to PM 23.10.80~~