



PRIME MINISTER

DEFENCE CASH LIMITS 1980-81

As you know, I have been discussing with the Secretary of State for Defence the acceleration in the rate of defence spending which has taken place during the first three months of this year, and which could lead to a substantial overspend on his cash limits if the present trend continues and no corrective measures are taken now.

2. Whereas we have defined the problem in our discussions, we have not been able to agree on the solution, since it involves a conflict between two important objectives of Government policy. But we agree that the conflict must be resolved quickly. I think therefore that the next step would be for us to have an early talk with you and the Chancellor with a view to reaching a solution which we might ask Cabinet to ratify.

3. As background for this discussion, I attach a paper, agreed at official level between the Treasury and the Ministry of Defence, which describes the problem and sets out the position of the two Departments.

4. The crux of the matter is that if the Defence cash limits are held to their present levels without adjustment, significant cuts will have to be made in the defence programme and there will be virtually no growth on last year's outturn. The Defence Secretary tells me that, as well as being militarily damaging, the cuts will be visible and are bound to lead to criticism at home and from our Allies. To restore the 1980-81 programme to the level planned in Cmnd 7841 would require an increase in the cash limits of around

£400m. I have established that an increase of some £300m would be sufficient to allow 3% growth on last year's outturn. But, as I explained to the Defence Secretary, an increase of £300m would lead to a corresponding increase in the PSBR, and this would endanger the successful achievement of our economic and financial policies. The danger would grow if other major spending Departments - none of whom are at present threatening to overspend - were to conclude that we were moving to a more liberal cash limits regime. The nationalised industries and local authorities would also take note.

5. To resolve this dilemma we need to find a formula which can serve two purposes. On the one hand, the Secretary of State looks for an increase in the volume of Defence spending this year: it is a matter of judgment what figure he could represent as a reasonable discharge of our obligation to NATO in a year of great economic difficulty. If the Secretary of State's position is sustained, UK's Defence spending this year would (on the NATO definition) be 4.0% higher in real terms than it was last year. This compares with planned increases of 3.3% in the US, 3.0% in France, 2.7% in West Germany and 2.2% in the Netherlands; and with planned reductions of 1.4% in Italy and 2.0% in Belgium. On the other hand, I am clear that I could not concede an increase of as much as £400m, or anything remotely approaching that figure, without jeopardising the achievement of our economic aims. To ensure that I can hold to the current policy on cash limits generally, if an increase has to be granted it must be much smaller than this, must be seen to be justified on grounds which are special to Defence, and must be a final settlement not subject to any further review.

6. The Defence Secretary and I believe that an early discussion with you and the Chancellor would help to resolve the dilemma and to produce such a formula. If you agree, you may wish to arrange an early meeting.

7. I am sending copies of this minute to the Chancellor and the Defence Secretary.

W J B

JOHN BIFFEN