

MO 8/2/12

PRIME MINISTER
THE DEFENCE PROGRAMME

A report from Mr Pym on the effects of this year's defence cut-backs. See also the Chief Secretary's comments at Flag A - he thinks further measures will be needed if Mod are to stay within their cash limit. We understand that Lt. Carrington is very concerned about our position vis-a-vis our allies if further volume cuts are made.

Following our discussions in August I believe that I should report the measures I have taken to restrain expenditure in the current financial year within the increased defence cash limit.

I started from a position where I had already authorised two tranches of reductions to save about £250M and so remove the unplanned growth in this year's programme caused by the industrial recession - the deferment of equipment projects, a major cut-back in the works programme, reduction in stocks, fuel savings and the postponement of schemes such as Assisted House Purchase. After allowing for the uplift in the cash limit agreed last month I was left with a substantial gap to be closed.

As an immediate step I imposed, initially for three months, a moratorium on all but essential defence contracts. To produce the necessary savings this had to be comprehensive applying to extra-mural research and development, capital equipment, lands, buildings and new construction, and the purchases of spares, stocks and reserves and repairs. I had, of course, to exempt the strategic nuclear deterrent and those contracts whose cancellation or deferment would have caused disproportionate financial or other penalty.

This should save £100M this year. The non financial cost is that the Services will within a few months begin to feel the effect of shortages of spares, and the reduced level of maintenance and repair; if long term damage is to be avoided the position must be recovered as early as possible next year.

There has also been political damage, particularly at the local level. I have been at pains to explain to industry, to trades and employers' associations why the moratorium has been necessary. I have found a measure of sympathy - senior industrial management at least are well aware of the difficulties of managing cash flow in a large organisation - but almost without exception this reduction in the flow of funds to industry is seen as a further shift from the public sector to the private



of the burden of the recession. Firms see high interest rates - for which they hold the Government directly responsible - and the economic recession as combining to create cash flow problems for them of a kind which force them to accelerate work on defence contracts. Redundancies in the defence sector are inevitable and some firms particularly subcontractors may go under. The apparent illogicality of forcing firms to borrow more money from the banks or to lay off workers, and put up the cost of unemployment benefit, in order to reduce defence expenditure is not lost on them, and will need the most careful handling when Parliament reassembles.

To find a further £100M this year I have also authorised cuts in personnel movements and freight, made savings in the purchase of nuclear materials, and made a major cut in planned fuel purchase. This will mean a substantial reduction in activity by all the armed Services during the remainder of the year. The time the Fleet spends at sea, and flying by the Air Transport Force and by the Long Range Maritime Patrol Force will be cut by 30%. Hydrographic surveys and offshore oil and gas rig patrols will be cut by 25%; collective Army training in the UK and Germany by between 35 and 45%; TA training by 25% and certain other forms of Army training by up to 30%. Our participation in NATO exercises will have to be reduced.

The measures outlined above inevitably involve a significant short term deterioration in the operational readiness and capability of our forces. In the very short term this is a risk which we have to run and we must pray that the situation in Northern Ireland remains calm and that we do not have to deploy forces elsewhere over the next few months. But they run absolutely and directly counter to the military need.

I have also had to authorise a drawing down of our war reserves of fuel (by $\frac{1}{4}$ in the case of the Army and the RAF) below the levels called for by NATO. Events in the Middle East underline the significance of this action, but I do not believe that less damaging savings that would have an effect this year can be found elsewhere. I shall however be monitoring the position very carefully.



I am continuing to keep expenditure under very careful review. Later this month I shall decide on the future of the contracts moratorium after the initial three month period expires on 8th November, and also whether further measures can and should be taken to restrain expenditure. My present view is that the moratorium in its existing form, although the only weapon available to me that would secure savings early enough in the financial year, would cause unacceptable damage to industry if continued too long and will have to be replaced by a somewhat different (but nevertheless very stringent) regime.

We are discussing with industry now the implications for defence suppliers of our very tight cash position, and we are trying to devise further ways of slowing down our cash flow for the rest of this year. To the extent that we are postponing necessary expenditure - whether by the moratorium or other means - this will increase the financial pressure next year. I am having to give very serious thought to how much money will be needed next year to support the programme we agreed in OD and to restore the temporary damage done this year. I am discussing this with the Chief Secretary.

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

3rd October 1980

Ministry of Defence