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MO 8/2/12

*Prime Minister*

*For Cabinet on  
Thursday.*

PRIME MINISTER

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

*PL 14/9*

DEFENCE EXPENDITURE IN THE PESC PERIOD

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

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

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

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

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

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

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

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

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

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

12th October 1979

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