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Mr Taylor

From the Principal Private Secretary

6 August 1980

Dear Brian,

DEFENCE EXPENDITURE 1980/81

Your Secretary of State called upon the Prime Minister this morning to follow up the meeting which he had had earlier in the day with the Chancellor of the Exchequer to discuss the Defence cash limit for 1980/81.

Mr. Pym said that the Chancellor of the Exchequer had offered an increase in the cash limit of £150m net. He had said in response that he would like to have a further word with the Prime Minister so that he was sure that she was aware of the implications of settling upon an increase of no more than this size. He understood the seriousness of the general economic situation and he was anxious that Defence should make a contribution to the economic recovery of the country. It was in the same spirit that the Chiefs of Staff were approaching the cash limit problem: they were being as helpful as they could, even though some very unpalatable measures such as reductions in ship and aircraft movements would have to be taken in order to bring the programme into line with the new cash limit. The morale of the services was bound to be affected. The primary concern of both himself and the Chiefs of Staff, however, was with 1981/82 and the later years. He had asked the Chancellor at their meeting when we might be able to get back to the NATO commitment of real growth of 3% a year in defence expenditure. The Chancellor had been unable to give any undertaking on this point and had re-emphasised how difficult 1981/82 was likely to be for public expenditure. He understood why the Chancellor was unable to offer any commitment at this stage but he nonetheless wanted to underline the importance of the United Kingdom continuing to give a lead in NATO and therefore of the need to get back to real growth of 3% a year as soon as possible.

The Defence Secretary went on to say that he and the Chancellor had agreed that public presentation of the decision to increase the cash limit by £150m should be as low key as possible. The Chancellor would announce the increase by a Written Answer on Friday, and he would himself let it be known in parallel that he was placing a moratorium on Defence contracts. It would take another 3 weeks or so to identify the other measures that would be needed to rein back the Defence programme and he proposed to let these become public knowledge in as gradual and low key way as possible. It would be important, however, to

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warn other members of the Cabinet of Friday's announcement and to prepare the Party, so far as was possible at the end of the last week before the recess, for what was to come. He proposed to circulate a brief note for tomorrow's meeting of the Cabinet to let colleagues know what decisions had been taken and what their implications were. He hoped that there would be no need for substantive discussion on the note. As regards the Parliamentary Party, he intended to see the officers of the Defence Committee to let them know that, for wider economic reasons, it was necessary to make cuts in the Defence programme. This would come as a surprise to them and they were bound to be disappointed.

As far as NATO was concerned, our position would be devalued once our allies came to understand the consequences of today's decision on the cash limit. Hitherto the Government had played its hand in such a way as to strengthen the alliance to a degree which was greater than our actual military contribution itself. But our ability to continue to do that would almost certainly now be reduced, and we would be thought to be weak when we had appeared to be strong. In reply to the inevitable questions about what our decisions meant for the NATO 3% commitment, he proposed to say that we had been forced to make these changes in our Defence programme by the need to respond to our general economic situation but that we would get back to real growth of 3% a year in our Defence expenditure as soon as we could.

The Prime Minister said that nobody was more disappointed than she that the Defence programme had to be cut and she would not be contemplating this course unless it was absolutely unavoidable. It was, however, vital to keep public expenditure under control if the Government's economic policy was to be successful. If we got the underlying base of the economy right, it would then be much easier to have real growth in Defence expenditure. She accepted a commitment to get back as soon as we could to real growth of 3% a year in Defence spending but she could not say when this would be. She was grateful to the Defence Secretary for acknowledging the need for his programme to make a contribution in the present economic situation and for agreeing that the Defence cash limit for the present year should be increased by no more than £150m. She was also grateful to the Chiefs of Staff for their cooperative approach. She agreed that the Defence Secretary should circulate to his Cabinet colleagues later that day a brief note reporting the decision on the cash limit and describing the implications for the Defence programme. It would be important that nothing leaked before Friday, and Mr. Pym should make it clear that his minute should have only a very restricted circulation. Similarly, he should impress upon the officers of the backbench Defence Committee when he saw them the need for secrecy until the announcement was made. The public presentation of the decision on the cash limit should be aimed at putting the increase in as good a light as possible. For example, we should make clear that in setting cash limits, the Defence programme was still receiving higher priority than civil programmes. Moreover, we could still show that in cash terms the Defence budget was growing this year by nearly 3%, though she acknowledged that Mr. Pym had always talked about the commitment to 3% growth in volume terms.

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I am sending copies of this letter to Martin Hall (Treasury)
and David Wright (Cabinet Office).

Yours ever,

Alfred Whittam.

B.M. Norbury, Esq.

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