

CONFIDENTIAL



PRIME MINISTER ✓

DEFENCE CASH LIMITS 1979/80

The Defence Secretary wrote to you on 2 July seeking an assurance that the defence cash limits would be further supplemented if in the event it proved impossible to absorb the additional costs imposed by the indirect tax increases without reining back the defence programme.

2. I am sure we should not make a public statement now which could be taken to indicate that the Defence Budget will be given special relief from the discipline of cash limits.

3. You will recall our exchanges before the Budget. Your Private Secretary wrote to mine on 5 June ^{see: Econ. Pol., Pt 2, Pub. Exp.} recording your view that there should be no easement of the cash limits policy as already decided and announced on account of the higher prices in the post-Budget forecast, but asking me to inform colleagues of the extra volume squeeze which this would imply. This I did in a minute of 8 June. ^{see: Econ. Pol., Pt 2, Pub. Exp.} No objections were raised at the Cabinet meeting which endorsed the Budget proposals.

4. To re-open the matter now would cast doubt on our Budget strategy and on our ability, and will, to maintain the control of public expenditure through the cash limits which is an essential part of our strategy. We cannot relieve a major programme, however important in its own right, from the constraints of cash limits without prejudicing the system. And we very much want to avoid adding to the borrowing requirement in the present year.

Con't.....

CONFIDENTIAL

4. It is not my field but I question the degree of criticism to be expected from our Allies. Of course they will ask questions, but at the political level our standing will surely remain high following our endorsement of the 3% target. There are some good points we can make:

- (i) we have just increased the defence cash limits for the current year by £409m -- substantially more than the cost of the tax increases; this included financing in full the generous pay award to the Armed Forces and protecting essential elements of the Defence Budget by allocating an additional £100m to equipment procurement;
- (ii) the extent of the volume squeeze resulting from the cash limits will depend on the rate of inflation; it is not something peculiar to the United Kingdom, but common to all countries which set their budgets in cash terms.

5. I must therefore recommend that the Defence Secretary should give no assurance that the Defence Budget will be compensated in the way he suggests.

6. I am sending copies of this minute to the Defence Secretary, to other members of OD Committee, the Lord President and Sir John Hunt.

WJB

JOHN BIFFEN (3.7.79)

JUL 4 1979



MEMORANDUM

TO :

FROM :

SUBJECT :