

PRIME MINISTER

cc: Mr. Cartledge

DEFENCE CASH LIMIT 1979-80

These papers involve a dispute between the Treasury and the Ministry of Defence about the application of this year's defence cash limit. They are asking you to adjudicate.

Mr. Pym (Flag A) is complaining that the VAT and petrol duty increase will add £180 m. to defence costs in the current year. He would like, if pressed, to be able to say that - if necessary in order to maintain the level of defence spending in real terms - additional funds will be provided during the course of the year. His argument is that the £180 m. additional cost more than outweighs the £100 m. extra provision which was given when the Government took office. The effect of this is further spelt out in his subsequent minute (Flag B).

The Chief Secretary (Flag C) argues that this would be directly against our cash limits policy; and more specifically, it would conflict with the policy that "there should be no easing of the cash limits policy as already decided and announced on account of the higher prices in the post-Budget forecast". The Chief Secretary, with your agreement, minuted colleagues to this effect before the Budget (Flag D), and Mr. Pym did not dissent at the time.

This is difficult. If the manifesto commitment to improve our defence effort is to be implemented this year, MOD will almost certainly need some additional funds later in the year; and Mr. Pym does indeed appear to be under some pressure to make his position clear. On the other hand, any such indication at this stage would undermine the Chancellor's posture on cash limits, and would suggest to some that the Government was going to relax on other cash limits when the going gets tough. One way out would be for the Chancellor to relax the defence cash limit so as to compensate for the indirect tax increases; but to find some offsetting savings elsewhere. However, I cannot believe this is feasible.

/ Do you

Do you wish to stand by your earlier decision that there should be no easement of cash limits, including MOD's; or will you agree that Mr. Pym should say, if necessary, that the tax increases will not lead to cuts in the defence programme (and by implication the cash limit will be adjusted upwards)?

R
..

We are not going to demoralise
the whole of our Armed Services ~~just~~
~~because we have put up~~ by taking
out more in V.A.T. than we added in
cash limit. We then except them for
the V.A.T. increase (if possible) or balance
it out by increasing the cash limit. Defence
is different from other departments.
R.P.

6 July 1979