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CABINET
DEFENCE AND OVERSEA POLICY COMMITTEE

THE DEFENCE PROGRAMME
Note by the Chancellor of the Exchequer

I support the Secretary of State for Defence's determination to tackle the massive over-commitment on the future defence programme, and develop more cost-effective force structures. I cannot support his case for major increases in defence expenditure.

2. The burden on national resources represented by defence expenditure is now at a post-war peak. The proposals in OD(81)29 would entail major increases in that burden. The choice on offer is between growth of:-

(a) 3% a year in volume terms, plus £200 million (1980 prices) a year, up to 1985-86; or

(b) 3% a year in volume terms up to 1987-88.

Option (a) would mean volume defence spending rising by 16%, and defence's share of GDP from 5.2 to 5.9%, over the next four years. Option (b) would also mean an increase in GDP share to 5.9%, and would produce a 19% volume increase over six years.

3. The conflict with our overall economic policies, and their public expenditure component, is stark. We shall be discussing in Cabinet later this month the prospects for achieving our financial and economic objectives, notably reduction in inflation, in the
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burden of taxation, and in interest rates. It is already clear that achievement depends crucially upon a reduction in the total public expenditure plans we published in our last White Paper (Cmd 8175).

4. Defence represents 13% of the total. If we secure no actual reduction in defence, therefore, the consequences for other programmes, including social security, health and law and order, will be worse. The exclusion from the forthcoming Public Expenditure Survey which the Secretary of State for Defence seeks is therefore a matter which Cabinet will wish to decide.

5. Subject to Cabinet's views, however, I would myself be prepared to go a long way towards meeting the Secretary of State for Defence's objectives, and to support the confirmation of the Cmd 8175 defence figures, which provide for 3% growth in 1982-83 and 1983-84. I accept this as consistent with out NATO and other pledges, though none of us should overlook the fact that it has always been accepted in NATO that national economic circumstances may necessitate short-falls against the 3% target - an escape clause of which other Allies have made frequent use.

6. We are in no way committed to 3% growth beyond the Cmd 8175 timescale; and I could not support a proposal to Cabinet that we should now commit ourselves to its extension to 1987-88, nor of course to even more rapid growth up to 1985-86.

7. Our agreement to plan in cash means that we should take our decisions in cash, and then stick to them, regardless of what happens to costs, as do our NATO partners. My proposal therefore is that the core defence programme should be made consistent with:-

(a) the 1982-83 and 1983-84 Cmd 8175 figures, revalued to cash using the general inflation factors agreed finally by Cabinet in the autumn or subsequently for programmes generally.

(There should be no addition for Trident, or for extra costs,

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if any, of armed forces pay, or for any extra costs which might materialise in future in defence procurement: in the very recent past the costs of defence procurement have been rising more slowly than other public sector costs); and

(b) constant real expenditure in and after 1984-85.

To plan on a less realistic assumption about what we are likely in practice to be able to afford in the mid-80s would be to court a repetition of the over-commitment which the Secretary of State for Defence is determined to eliminate.

Conclusions

8. In short, I endorse the direction of policy set out in OD(81)29, but can accept neither of the proposed future resource allocation commitments. Provided that Cabinet agrees that overall public expenditure policies are not thereby prejudiced, I should be prepared not to seek reductions in published defence programme plans, but I must ask that the Secretary of State for Defence assumes no further increased beyond the period of the published plans.

(G.H.)

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