



Prime Minister

A ~~short~~ note from Mr Pym on what further measures may be needed to stay within the revised cash limit.

MO 8/2/12

PRIME MINISTERTHE DEFENCE PROGRAMME

In my minute of 3rd October I reported the measures I had taken to restrain expenditure in the current financial year within the increased defence cash limit. The Chief Secretary subsequently offered the view, based on the end-September FIS figures, (his letter of 8th October) that I was still on course for an overspend of at least £250m.

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? 2. I agree that on present trends an overspend seems very likely. But the situation is difficult to read and a wide range of uncertainty remains. The judgement of the staff responsible for the programme suggests a possible excess lower than £250m. But, as the Chief Secretary says, the rate of presentation of bills continues to be worryingly high. This is an entirely new phenomenon. There is no sign of a falling off yet, but it must fall if expenditure is to be restrained within the cash limit. Because of the lag in presentation and payment of bills, it is not surprising that the drastic cuts I have already made have not produced a downturn in payments yet. I am watching the position with great care.

3. My major difficulty lies with the main procurement Vote. My other Votes are being contained well within their cash limits. Procurement has been particularly hard hit by this year's economic conditions, both the recession and high inflation.

4. If the downturn in payments does not come quickly enough, or is not big enough, to bring expenditure within the cash limit I will have to ration severely the money that goes to industry on existing contracts - this may raise major contractual difficulties - in order to slow down the haemorrhage in our cash flow to industry. In present economic conditions this will create very great difficulties for our suppliers, yet I need their co-operation. Like many other of the measures I have taken its effect will be very visible. Our discussions with industry continue and I shall report further as necessary.



5. But I have also been considering what immediate further cuts in the defence programme are practical possibilities. The room for manoeuvre is now minimal. The initial 3 month period of the moratorium on new defence contracts expires on 8th November. I have decided that it must be discontinued in its present form and replaced by a period of maximum restraint on new commitments. During this period new commitments will continue to be scrutinised individually and allowed to go ahead only if the penalties of cancellation or deferment are disproportionate. But I shall have to allow some exceptions in certain areas, for example, the purchase of stocks and spares, and contract repairs. Otherwise the damage, in the form of shortages, reduced levels of maintenance and loss in the capacity of our forces to operate, will simply be too high. I shall also watch the effect on industry most carefully. In general firms have endured the moratorium so far, but many of the smaller ones will be placed in great difficulty by a longer period of restraint. Many firms, large and small, will have to lay off labour and some may close altogether. There is no avoiding such consequences. But I must try to protect from collapse those firms which are a sole or major source of supply to my Department. If I do not do this, whole capabilities in British industry will disappear and alternatives to foreign purchase will be denied us.

6. I am also considering further cuts in the levels of activity of the armed forces, in addition to those described in my minute of 3rd October. Such cuts would carry very heavy penalties indeed. One option I am having examined is the closure of a number of defence establishments for a period of weeks in order to cut costs. I shall report my conclusions.

The temporary closure of establishments would be unprecedented, and given that the MOD would have to go on paying the staff, I should not have thought that such a step would have produced savings big enough to make the accompanying raw materials...

7. I am very concerned that the quite exceptional difficulties which the defence programme has faced this year should have required me to take, or contemplate, measures of this kind I have described in this minute and my minute of 3rd October. The scale of economies and reductions in the activities of the Armed Forces which I have had to enforce is without precedent known to me, and they run clean contrary to the military need. The cause of our difficulties are:

- a. Inflation has been substantially greater than allowed for in the cash limit.

- Not now
Return limit
3rd month
very substantially
down.

tbl.



b. Some of our suppliers have been making faster progress with their contracts than anything known before and sending in their bills more quickly: this is the direct consequences of the recession and the lack of other work.

c. Industry's overheads in many cases appear to have risen more than could have been forecast. A separate quantitative value cannot readily be assigned to these factors, but I am having further analysis done urgently. If the economic and industrial conditions which have created such difficulty this year were to persist, or even get worse, their continuing effect on my ability to sustain next year a programme which approaches military needs and our international obligations could be very serious indeed, whatever decisions we reach on future volume figures.

8. I am sending copies of this minute to the members of OD, to the Secretaries of State for Industry and Employment, and to Sir Robert Armstrong.

*Are we on
GII plus
contracts?*

Ministry of Defence

23rd October 1980