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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

DEFENCE EXPENDITURE 1981-82

The Defence Secretary suggested that you might wish to call a restricted meeting to discuss the issues raised in his minute of 11 March. I would value such a discussion.

TPM

2. I welcome John Nott's recognition that significant changes are required to bring the defence equipment programme back to a coherent and sustainable level. It is absurd that the MOD internal costings procedures should over the past year have produced expenditure plans for 1981-82 amounting to £850 million in excess of available resources. Like John Biffen, I am sure that for the medium and long term it is necessary to devise a more realistic programme.

3. I well understand how limited is the room for manoeuvre in the short term but the Defence Secretary's proposals for 1981-82 raise two difficult propositions.

4. The first is that he should not be obliged to abide by the Defence programme agreed by Cabinet last November, and published in the recent White Paper. I recognise that he is not arguing that he cannot deliver cuts amounting to the £200 million agreed by Cabinet. But maintains that the momentum of the equipment programme is now such that cuts greater than earlier foreseen (£141 million on top of the £160 million already approved), and greater than he could recommend, would be required to hold the programme to the agreed level.

/Though we



5. Though we agreed that the cash limit should be subject to a mid-year review, it would be quite out with the scope of such a review to consider so increasing it as to accommodate a larger programme. Colleagues, and the country, would rightly see this as reopening last November's decisions. We have just stated publicly that the present public expenditure totals are higher than we wish and that this requires the most serious attention in reviewing future flows. How can we start by failing now even to hold to the totals we agreed?

6. I am in no position to assess the risk, to which John Nott refers, that continuing acceleration of Defence work in industry, may defeat the efforts which the Ministry are now making, on his instructions, to introduce more effective control of cash flow. I cannot therefore judge whether individual measures listed "below the line" in the Annex to his minute will be required. Certainly I have no doubt - because we have discussed the problems together - that John faces real difficulties. But then so do I!

7. In these circumstances, I am quite sure that the programme must be brought into line with the cash limit. If in John's judgement that will require him to take all or any of these measures, I have to say that I believe he must do so.

8. No less serious is the suggestion (paragraph 10 of his minute) that it will not be possible for him to accommodate a deduction in 1981-82 to compensate for the expected overspend in 1980-81. The principle that overspends are compensated by commensurate deductions in the following year is a central feature of the cash limits discipline, accepted by Francis Pym last autumn, and many times stated publicly.

9. I am told that the measures which the Ministry have taken to reduce cash flow in the closing months of this year

/are having



are having considerable effect, and that the overspend may in the end be a little below £300 million. How the deduction is to be made will be for decision at the time of the cash limit review. But despite all the difficulties, it is my view that Defence officials should devise appropriate contingency plans well in advance.

10. We need to keep the problem in perspective. The sums under discussion are marginal in relation to a Defence Budget of £12.3 billion. The cash limits, the total on which our discussion should focus, is £11.5 billion, half for procurement. It might assist us to have a functional breakdown of how the bulk of the Defence money is to be spent in 1981-82, to complement the note which John Nott has circulated on particular measures which might be taken to create the necessary savings at the margin.

11. I am sending copies of this minute to John Nott and to the Home Secretary, the Foreign Secretary, the Secretary of State for Industry and Sir Robert Armstrong.

(G.H.)

16 March 1981