

BV

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

C(82) 33

COPY NO

83

7 September 1982

CABINET

LONG-TERM PUBLIC EXPENDITURE

Memorandum by the Secretary of State for Defence

1. We are to discuss this subject on 9 September.
2. Poor economic performance and the demands of public expenditure have combined to make it difficult to achieve our aim of reducing public expenditure as a proportion of Gross Domestic Product (GDP) - although such a measure of the size of public spending begs, of course, a host of questions.
3. I agree therefore that we must look at radical options and I accept that the implications of a lower rate of growth in defence expenditure cannot be excluded from our discussion.
4. I should observe that my Department has made clear that it does not consider that the figures have been sensibly presented in the report by officials. In that context I will confine myself to saying that I find it curious that while in Public Expenditure Survey negotiations the Treasury do not recognise the existence of the defence Relative Price Effect, in the officials' report projections of defence expenditure have been increased by including an extra 2 per cent per annum allowance for it (an extra £1.6 billion a year by 1990-91)!
5. But, on substance, I should like to place on record, before our discussion, my view that a decision by the United Kingdom to level off defence spending after 1985-86, which the Central Policy Review Staff suggest to be the main defence option and might be implied by the Chancellor of the Exchequer's note, would lead to a rapid diminution of our defence capabilities and would further gravely undermine the effectiveness and political cohesion of the Alliance.
6. In recent years our experience, like that of all our allies, has been that the capital production costs of successive generations of major equipments have risen by an average annual figure of 6-10 per cent in real terms. There is no reason to suppose that this phenomenon will not continue in the future; it may indeed get worse. The sharp fall in the numbers of all our major front-

line assets in recent years is a direct reflection of this increase in real costs. Our planned reduction from 65 frigates when we assumed office to 50 in future years has received the greatest attention - but it is happening elsewhere as well.

7. It was against this background that NATO Ministers decided to extend the aim of 3 per cent annual growth in the volume of defence spending until 1988. So far performance against the 3 per cent target has been mixed and as the table below shows the United Kingdom, albeit starting from a relatively high percentage of Gross National Product, has not performed as well as our major allies since we assumed office, in spite of our Manifesto commitments.

Real Increases in Defence Expenditure by NATO Countries 1979-81

<u>Country</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> <u>(provisional)</u>	<u>Average</u> <u>1979-81</u>	<u>Ranking</u>
United States	3.7	5.0	5.7	4.8	1
France	2.5	3.9	3.5	3.3	2
Italy	2.6	4.9	1.5	3.0	3
Germany	1.8	1.9	3.4	2.4	4
United Kingdom	2.1	2.9	1.7	2.2	5

8. We have been able to make some modest improvements to our defence capability. But major deficiencies remain - for example, we still have no more than 100 air defence aircraft in the United Kingdom - and in the late 1980s we will be operating a large number of aircraft more than 20 years old for which there is no prospect of early replacement (Buccaneers, Phantoms, etc). The Army's new tank, Challenger, will be equipping only half of the tank fleet. Our combat stocks in Germany could not sustain hostilities for more than four to five days at intense rates - possibly our most serious deficiency.

9. There is no sign whatever that the Soviet Union is proposing to cut back the scale of her investment in modern, sophisticated and efficient nuclear and conventional forces. Beside our forces, her capability in modern ships, tanks and particularly combat aircraft is quite overwhelming - and even the wide gap with NATO's capability is widening alarmingly. Her readiness to make use of her military power both directly and indirectly in pursuit of political objectives is only too apparent.

10. There is thus every reason to suppose that we shall continue to need at least a 3 per cent annual increase in expenditure if we are to maintain an adequate defence and deterrent capability. As shown above, we have fallen considerably short of this commitment. In short, the cost of security must be determined by factors other than pressures on public expenditure, and defence which today absorbs 10.3 per cent of general Government expenditure, central and local, really needs to be restored to a position nearer the average of the 1960s, around 15 per cent of total Government expenditure, if

SECRET

we are to retain coherent defences into the 1990s. It is not defence expenditure which needs curbing - it takes about 4.9 per cent of GDP today against an average of about 6 per cent of GDP in the 1960s when the threat was no greater - but public expenditure generally, if that can be done.

J N

Ministry of Defence

7 September 1982

SECRET