

Prime Minister

MO 26/11/17  
MO 8/2/12



PRIME MINISTER

① Yes  
② I am afraid to look at any alternatives. I doubt whether MOD can afford any replacement aircraft

① Agree that action on the Jetstream order should be suspended until the problem of the MOD's cash limit for 1980/81 is settled?  
② As regards paragraph 4 below, do you want to stand firmly by your decision that if any aircraft is to be bought, it is to be Jetstream? Or would you like a review of all the options, as Mr Lynn suggests. If you do, I think the MOD should produce a paper setting out the alternatives, with costs and timescales. This could then serve as the basis for a meeting of all the Ministers concerned. How would you like to proceed?

In his letter of 10th July to Mr Sanders, my Private Secretary explained where matters stood on the contract for the purchase of the Jetstream. *7 was kind of present. no.*

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2. We have now completed discussions with British Aerospace on an alternative form of contract and I attach a note which sets out the outcome. I am myself clear that if we were to proceed now with the Jetstream purchase, we should do so on the basis of the revised quotation. This would help us over the amount of expenditure in the current financial year and get round the potential difficulty of my having to instruct the Accounting Officers to proceed with a contract which they regard as contrary to proper practice. There would remain the need for me to issue a formal direction to the Chief of Defence Procurement to buy other than in the most economical fashion but this is not an overriding consideration.

3. There remains however the question of whether we should now proceed with the purchase of any aircraft to meet the RAF requirement until we have reached a view on the uplift of the defence cash limit in the current year, taking account of the forecast overspend and of our commitment to NATO of 3% real growth. Defence and Treasury officials have been instructed to analyse the very latest forecasts of out-turn for the rest of the financial year, and we should be able to reach decisions, on the basis of their detailed report, within the next three weeks. Until then I do not believe I would be justified in proceeding with this order. The indications are that British Aerospace will be prepared to extend both quotations for at least a further week until 23rd July. If we are to delay a decision as I propose, we should need to seek to extend the quotations for a further period.

4. I wonder whether we should not use the time available while we are reviewing the defence cash limit to look again at the alternatives open to us. There are three possible outcomes:

a. If the adjustment to the cash limit is such that



no new orders are possible for the remainder of the financial year, a decision on any purchase from British Aerospace or from overseas to satisfy the RAF requirement will need to be postponed once more.

b. Providing the cash limit is sufficient to allow some new orders to go ahead this year, we could proceed with the Jetstream on the basis of the revised quotation.

c. If the cash limit outcome is satisfactory and adequate arrangements can be made for sharing the cost, we might look again at the possibility of proceeding with the purchase of the much cheaper alternative, the Beechcraft, coupled with placing an early order for the last two available BAC 1-11s for the Queen's Flight. (We could not absorb all of the cost of the 1-11s in the current financial year but such an order might be sufficiently attractive to British Aerospace for the phasing of expenditure to be agreed in a proper and mutually satisfactory way.)

5. I am conscious that all these options have already been looked at over a long period of time. Nevertheless, I do not believe we should go ahead now and you may feel it will be worth having a further discussion of the alternatives open to us.

6. I am sending copies of this minute to the Secretary of State for Industry, the other members of E(EA), and to Sir Robert Armstrong.

Ministry of Defence

16th July 1980

JETSTREAM 31

A revised quotation has been received from British Aerospace (BAe) for the procurement of fourteen Jetstream 31 aircraft based on more normal stage payment arrangements as opposed to the advanced payment scheme which underlies their existing offer.

Revised quotation

2. The revised quotation was received on Monday evening from BAe. In the time available it has been possible to carry out only a limited evaluation of their new offer. BAe have quoted a revised fixed price of £16.352M, including the £0.625M due from DOI and the Department of Employment, with provision for price variation to take account of inflation over the period of the stage payments from February 1980. A number of the detailed contractual proposals made by BAe are unacceptable. It would be necessary to undertake further negotiations on these points if this course were to be followed. The particular points of difficulty are:

- a. BAe's stipulation that a down payment should be made to the Company on acceptance of the offer;
- b. the BAe proposal that incidence of payments should be aligned with particular dates rather than achievement of work;
- c. the scope and details of the Variation of Price proposals in that BAe wish to apply these to the total price when it is Ministry practice to have a fixed element of usually 10%, and the Company have proposed an excessive period for the application of these arrangements.

Our success in negotiating a concession on these issues would have a considerable effect on the relative cost advantages of the two offers now on the table, although knowledge of the Government's support for the Jetstream 31 is bound to weaken our negotiating position.

Estimated cost differences between the two quotations

3. By applying discounted cash flow techniques on the basis of the best though informal advice available from the Treasury and our own Economic Adviser as to future inflation and interest rates over the period of the stage payments, the cost comparison of the two

quotations is as follows:

| £M  | 80/81 | 81/82 | 82/83 | 83/84 | Total |
|---|-------|-------|-------|-------|-------|
| Existing Quotation                                    | 16.5  | -     | -     | -     | 16.5  |
| Revised Quotation<br>(Discounted to<br>present value) | 3.4   | 7.1   | 8.1   | 0.2   | 18.8  |

In calculating the above comparison, an average interest rate of 15% has been assumed over the period 1979/80 to 1982/83 and inflation rates of 20% for 1979/80, 17% for 1980/81, 15% for 1981/82 and 12% for 1982/83 have been used. The precision of the above comparison depends on these assumed inflation and interest rates over the next four years, and the difference between the two quotations could be narrowed both by changes in these assumptions and by progress on the contractual points made in the previous paragraph. As an illustration of the effect of possible changes, a reduction of 3% in assumed inflation rates, coupled with a successful re-negotiation of a fixed price element within the price, would reduce the gap between the two quotations from £2.3M to as little as £0.5M.

4. It is, moreover, right to point out that a calculation on these lines depends upon the assumption that money is freely available at the assumed interest rate for either course of action. Given the pressure on our cash limit, the £16.5M for Jetstream in 1980/81 could be made available only by deferring expenditure on some other project or projects, which would then suffer a similar DCF diseconomy. That is to say, we might save on the Jetstream only at the expense of paying more on some other project.

#### Conclusions

5. Taking into account the current severe cash problems, the impropriety of making advance payments to BAe under the first quotation, and the uncertainty over the precise balance of cost advantage between the two quotations, the Accounting Officers consider it would be preferable to proceed with any Jetstream purchase on the basis of the revised quotation. The first step would be to place an Intention to Proceed while seeking to renegotiate the points of contractual detail to the best advantage of the Department.

Ministry of Defence  
16 July 1980

16 JUL 1980



CONFIDENTIAL

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07/7



cc D/Ind D/N  
Emp CSO  
DOE CO  
SO  
WO  
DOT

10 DOWNING STREET

*From the Private Secretary*

17 July 1980

The Prime Minister has now seen your Secretary of State's minute of 16 July, about the proposed purchase of the Jetstream in relation to the cash limit for 1980/81.

In the light of recent developments over the cash limit, the Prime Minister agrees that action on the proposed Jetstream purchase should be suspended pending settlement of the cash limit issue.

The Prime Minister has noted your Secretary of State's suggestion that the opportunity of this delay should be taken to look again at the alternatives open to us. She is prepared to look at any alternative, although she has expressed her doubt as to whether the defence budget has room for any replacement aircraft of this kind at present.

I am sending copies of this letter to the Private Secretaries to the members of E(EA) and to David Wright (Cabinet Office).

M. A. PATTISON

David Oman, Esq.,  
Ministry of Defence

CONFIDENTIAL

JD

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MO 8/2/12

PRIME MINISTER

10th July 1980

*Jetstream purchase has yet to be finalised.  
Mr Pym will minute you next week confirming that  
he is about to instruct his Accounting Officers to  
proceed, despite the obstacles noted here.*

Dear Nick,

MOD CASH LIMIT 1980/81: JETSTREAM

In your letter of 1 July you said that the Prime Minister was watching progress on the contract for purchase of the Jetstream. This is a progress report on where matters stand.

The Defence Secretary has very recently been reviewing again the trend of expenditure in the current year in relation to the MOD cash limit. There are indications of an increasing volume in procurement expenditure as industry, for lack of other orders, gives increasing attention to defence work and submits bills faster. On top of this prices are increasing at a very much higher rate than was allowed for when the cash limit was set (for example, increased oil prices will cost us £130M more than was allowed for). The Defence Secretary has therefore taken steps to restrain the volume of the programme within the totals by making programme cuts of £150M. It may be necessary for more cuts to follow. It seems likely that most, if not all, of the new projects which were due to start later this year will not now go ahead. Discussions with the Treasury are, of course, taking place.

Against this background my Secretary of State would not normally have agreed to the purchase of a replacement aircraft at this time because this

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10 Downing Street

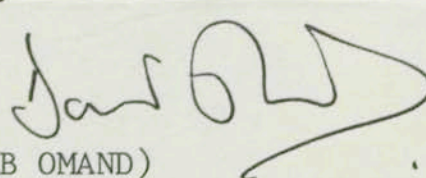


is not a requirement of the highest priority. The decision to buy the much more expensive British aircraft makes the issue no easier. The Defence Secretary has been advised that in order to comply with their obligations to Parliament he must instruct the Accounting Officers to buy other than in the most economical fashion.

There is a second difficulty. The existing British Aerospace quotation rests on our making a large payment in advance of the work done. This is contrary to proper practice. The Accounting Officers would not be willing to proceed on this basis without a further direction covering this point, which is likely to need special notification to the Comptroller and Auditor General. Against this background, Mr Pym has instructed his officials to obtain a revised quotation based on progress payments related to the manufacture and delivery of the aircraft, so that we can assess the contractual and financial merits of proceeding with this course as compared with the existing proposal. British Aerospace hope to produce a revised quotation on this basis by 16th July. We will keep you informed.

I am also told that some of the other Departments involved have a problem over the propriety of their expenditure.

I am sending copies to the Private Secretaries to the Secretary of State for Industry and the other members of E(EA), and to David Wright in Sir Robert Armstrong's office.

Yours ever,  
  
(D B OMAND)





111 JUL 1980



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SCOTTISH OFFICE  
WHITEHALL, LONDON SW1A 2AU

*I agree with the  
sentiments expressed  
by G.Y. This one initially  
came to me as a matter  
which had to be  
decided within  
24 hours!  
mb.*

*Prime Minister  
For the record, as you  
have agreed that cash limit  
issue must be resolved  
first.  
MAP  
18/7/11*

CONFIDENTIAL

Prime Minister

JETSTREAM 31

I have seen Francis Pym's minute of 16 July which, in effect, invites us to re-open the decision taken and recently re-affirmed to order Jetstream rather than an American aircraft for the RAF communications requirement.

I am not familiar with the details of the cash limit constraints which inhibit action by the Ministry of Defence, but it seems to me that there are inconsistencies in the argument presented to you. We have been told hitherto that the need for a replacement communications aircraft for the RAF is urgent and that that is a consideration in favour of the American machine: yet Francis is now counselling further delay with the clear implication that one option is to postpone indefinitely any order. I am bound to ask whether a replacement aircraft is being sought because it is needed, or because money was expected to be available in the defence vote, and also whether the review of the cash limit is to be confined in its practical effects to this particular order only?

I observe also that the possibility of buying BAC1-11 aircraft for the Queen's Flight is advanced yet again. I do not see how this proposition can seriously be considered in what is said to be a position of extreme financial stringency, or how the purchase of two aircraft off the shelf, largely to suit the convenience of British Aerospace and to fit expenditure within constraints imposed at our own hand, could be allowed to crowd out a project which offers 1,000 jobs for a considerable period of time and assurance of the future of a factory in an area of acute unemployment.

As to which quotation by British Aerospace for the Jetstream is to be preferred, I would regard this for decision by Francis in consultation with Treasury Ministers rather than for collective consideration. My concern is our apparent inability to implement your clear, firm instruction that Jetstream should be ordered - an instruction based, in my view, on overwhelming arguments of advantage to the national economy. We shall be accused, rightly, of vaccillation and infirmity of purpose unless this order is confirmed without further delay.

I am copying this minute to Francis Pym, Sir Keith Joseph, other members of E(EA) and to Sir Robert Armstrong.

*G.Y.*

STATION OFFICE  
ST. LOUIS, MO.

17 JUL 1980

