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Secretary of State for Industry

2. April 1980

The Rt Hon Francis Pym MC MP
Secretary of State for Defence
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Handwritten notes:
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M.D.
Prime Minister
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P.M.

Handwritten routing slip:
PS/Prime Minister 2
PS/Chancellor 3
PS/R Armstrong 4

Dear Francis.

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REVIEW OF DEFENCE REQUIREMENTS

At last Thursday's meeting of OD I set out some of the implications for industry which would flow from the sort of measures you indicated might be required to bring defence plans within the target limits. I am now writing to describe these in greater detail, in relation both to defence suppliers in general and to the privatisation of British Aerospace in particular.

I think you appreciate the general point that cuts in procurement of defence equipment from certain home suppliers could have a drastic and lasting effect on a number of them, and on the country's industrial capacity to continue to compete internationally in a number of sectors where we have strong companies with good export records. Nor are the implications confined to military products alone; civil products made by companies in the electronics industry, for example, often owe much to military developments. These considerations reinforce the need, already discussed between Adam Butler and Euan Strathcona, for the Department of Industry to be fully engaged in the defence review, in order to ensure that the various alternatives put forward for decision take full account of industrial implications.

Although the options for cuts in the defence programme are not fully defined, it is already clear that retrenchment on the scale being contemplated would have a particularly damaging effect on British Aerospace and put the country's capability to produce high technology defence equipment seriously at risk. It could, for example, mean the end of our capability to produce major new combat aircraft. The effect of changes in procurement of existing missiles and of reconsideration of new missile developments could be severely damaging to the British Aerospace Dynamics Group. In the long

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term we could be left with a shadow of the successful industry that exists today.

This would be serious at any time. It is particularly worrying when it is realised that the first of the privatisation measures to which we attach great weight, and in which we have invested much political capital, affects British Aerospace. I reported at OD that the present uncertainty about the defence review makes it impossible for us to proceed with our plans, to which a great deal of work has been devoted, of making an issue in May or June. (The OD minutes incidentally do not record my reference to the other considerations which affect the flotation). My firm legal advice is that, without disclosing what is at issue, it would be wrong for the Government to attempt to sell shares in a company which might be subject to the radical and harmful changes you now propose. The very existence of these plans has, in fact, caused me to draw back from a summer flotation.

This delay is regrettable and it is all the more important that the defence review should not prevent us from proceeding with the flotation at the next opportunity open to us, which will fall in late October, November or December this year. For this flotation to be possible, we need to do two things. First, we must have concluded the defence review in good time, so that uncertainties are removed. I believe your present timetable will make this possible, but I must underline the need to adhere to it. Secondly, we must take decisions which, once made, will still enable British Aerospace to be privatised. It is already clear that the flotation will not be easy, and some of the contingencies being considered would almost certainly make a flotation impossible during the life of this Parliament. It will, therefore, be essential to consider the effect on the flotation of the various measures being considered.

If we are to do this effectively, I consider it necessary to be able to expose to my merchant bank advisers, the Bank of England and Kleinwort Benson, what is under discussion. If we were not to seek their advice we would run the considerable risk that we should not appreciate fully the effect of some possible decisions on the flotation. I should, of course, consult on a basis of extremely limited involvement in either the Bank or Kleinwort Benson, and I would make clear the need for complete secrecy. Those with whom I believe it necessary to discuss these issues in the two banks have in the past proved themselves utterly reliable in their respecting of confidential information. I would arrange for my officials to clear with yours the acceptability of the individuals in the Banks who would be consulted. I see great advantage in starting these discussions as soon as possible: the more we delay, the greater the risk that we shall be prevented from taking any measure

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to privatise British Aerospace this year.

I am copying this letter to the Prime Minister, the Chancellor and Sir Robert Armstrong.

Yours

Kent

25 APR 1960

