

SUBJECT

SECRET



file DSS
2
cc Master

10 DOWNING STREET

From the Private Secretary

21 October 1982

Dear Richard,

DEFENCE EXPENDITURE

The Prime Minister had a discussion on 18 October with the Chancellor of the Exchequer, your Secretary of State and the Chief Secretary (HM Treasury) about the defence programme. The annotated agenda which was sent to me under cover of John Gieve's letter of 14 October served as the basis for the discussion.

Your Secretary of State said that he had originally bid for additions of £215 million in 1983/84, £566 million in 1984/85 and £606 million in 1985/86 in order to restore the NATO 3% growth commitment to the defence budget. In the light of the Treasury's latest inflation forecasts and the public sector pay factor for 1983/84, he had revised this bid downwards to a reduction of £43.5 million in 1983/84, together with additions of £46.7 million in 1984/85 and £50.2 million in 1985/86. He had reduced his bid in this way notwithstanding the Treasury's earlier position that the cash defence budget planning figures were inviolate and he gave notice that the adequacy of the cash provision should be reviewed next year if the inflation forecasts proved over optimistic.

As to the financing of the 1982 Armed Forces Pay Review Body and other Review Body awards, it was essential for both political and purely defence reasons that the cost of these awards should be added to the defence budget totals: it was both a matter of principle that the defence budget should be compensated in this way as it had been over the past three years, and as a matter of practice the Services were anxious that there should be no question of their equipment programmes being cut to find room for the cost of their pay awards. Your Secretary of State said that he recognised that the principle of thus compensating the defence budget for the Review Body awards might need to be given up after the General Election; but for the present there could be no question of requiring the defence budget to accommodate these sums.

The Chief Secretary said that he could agree to the adjustments to the defence budget sought by the Defence Secretary with a view to restoring the NATO 3% growth commitment (i.e. the line of figures in paragraph 2 of the annotated agenda). He did not accept, however, the Defence Secretary's reasoning for making these adjustments; but, since he could agree the figures, he saw no point in attempting to reach agreement on what the proper basis for any such adjustments could be. On the Review Body awards, it had, in fact, never been a principle that the defence budget should be compensated. Mr. Nott had accepted that the cost of £33.4 million in 1982/83 could be accommodated within the existing defence budget total. The figures for future years could, in practice, and should, be similarly accommodated.

SECRET

/ After

After discussion, the Prime Minister said it was agreed that the costs of the Review Bodies awards from 1983/84 to 1985/86 should be added to the agreed defence budget totals. The Defence Secretary would, however, withdraw his bid for an allowance totalling some £1½ billion over the three years (i.e. line (iii) in paragraph 1 of the annotated agenda) for defence non-pay relative price effect on the understanding that the adequacy of the cash provision was open to review, as last year, in the light of the movement in defence prices. The adjustments set out in paragraph 2 of the annotated agenda should also be made.

There followed discussion of Falklands expenditure. Your Secretary of State recalled that the Government had announced that all the equipment lost in the Falklands conflict would be replaced - not necessarily on a like for like basis - and that these costs, together with the cost of the Falklands campaign and of any future garrison, would be met out of monies in addition to the 3% annual rate of real growth. The best available assessment of the full additional cost of the campaign and of replacing lost equipment in cash terms was £725 million in 1982/83, £223 million in 1983/84, £334 million in 1984/85 and £313 million in 1985/86; a further £365 million (at 1982/83 prices) would be required for the later years. The Chief Secretary proposed that these costs should be re-phased as between the three years 1983/84 to 1985/86 as follows:-

1983/84:	£200 million
1984/85:	£345 million
1985/86:	£325 million

Your Secretary of State said that he would prefer that the 1983/84 figure should be £213 million: he would consider whether this could be further reduced. Subsequently you have confirmed that your Secretary of State and the Chief Secretary have agreed that firm additions to the defence budget should be made of £200 million in 1983/84, £350 million in 1984/85 and £320 million in 1985/86.

On the costs of the Falklands garrison the Secretary of State proposed that the interests of control would be best served by allocating fixed sums and including them in the defence budget. If that was accepted, he would be prepared to argue at OD(FAF) that any additional costs should be met from the defence budget. After discussion it was agreed that the sums to be added to the defence budget, at 1982/83 prices, should be 1983/84: £400 million; 1984/85: £300 million; and 1985/86: £200 million. This estimate rested on the assumption of an airfield costing around £220 million and of a configuration of forces on the following lines:

1 SSN	5 other helicopters
2 Frigates	8 Rapier fire units -
3 Patrol Craft	with a total onshore
1 Ice Patrol Ship	strength not exceeding
1 Oiler	2,000
1 Battalion	
6 Phantoms	
2 Hercules	
3 Chinooks	

SECRET

At the end of the meeting the Defence Secretary mentioned his plan to purchase four second-hand wide-bodied jets (DC 10 freighters) for mid-air refuelling. He would be obliged to purchase these from the USA, and his intention would be to find as much as possible of the cost of purchase of these aircraft within this year's defence budget total. The costs of conversion were included within the provision of £400 million for the Falklands garrison next year. The Prime Minister noted the considerable operational advantages that this purchase would confer, and agreed that it would be important to bring forward as much of the cost as possible to within this year's expenditure.

I am sending copies of this letter to John Kerr and John Gieve (Treasury) and to Richard Hatfield (Cabinet Office).

Yours sincerely,

Michael Scholar

→

Richard Mottram, Esq.,
Ministry of Defence.

SECRET

COVERING SECRET



MINISTRY OF DEFENCE

MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 2111/3 (Direct Dialling)

01-218 9000 (Switchboard)

MO 8

21st October 1982

*Richard
Mettram*

Dear Michael, PA

/ We spoke and I now attach a copy of the amendments to your draft record which my Secretary of State would wish to have made.

A copy of this letter goes to John Gieve.

Your ever

Mich Evans.

(N H R EVANS)

M C Scholar Esq

COVERING SECRET

*No instructions required*DEFENCE EXPENDITURE

The Prime Minister had a discussion this afternoon with the Chancellor of the Exchequer, your Secretary of State, and the Chief Secretary (HM Treasury) about the defence programme. The annotated agenda which was sent to me under cover of John Gieve's letter of 14th October served as the basis for the discussion.

Your Secretary of State said that he had originally bid for additions of £215 million in 1983/84, £566 million in 1984/85, and £606 million in 1985/86 in order to restore the NATO 3% growth commitment to the defence budget. In the light of the Treasury's latest inflation forecasts and the public sector pay factor for 1983/84 he had revised this bid downwards to a reduction of £43.5 million in 1983/84, together with additions of £46.7 million in 1984/85 and £50.2 million in 1985/86. He had reduced his bid in this way notwithstanding the Treasury's earlier position that the cash defence budget planning figures were inviolate and on the understanding *and the* that the adequacy of the cash provision should be reviewed next year if the inflation forecasts proved over optimistic. *gave where that*

As to the financing of the 1982 Armed Forces Pay Review Body and other Review Body awards, it was essential for both political and purely defence reasons that the cost of these awards should be added to defence budget totals: it was both a matter of principle that the defence budget should be compensated in this way as it had been over the past three years, and as a matter of practice the Services were anxious that there should be no question of their equipment programmes being cut to find room for the cost of their pay awards. Your Secretary of State said that he recognised that the principle of thus compensating the defence budget for the Review Body awards might need to be reviewed after the General Election; but for the present there could be no question of requiring the defence budget to accommodate these sums.

*
would
need to be
given up
after

The Chief Secretary said that he could agree to the adjustments to the defence budget sought by the Defence Secretary with a view to restoring the NATO 3% growth commitment (i.e. the line of figures in paragraph 2 of the annotated agenda). He did not accept, however, the Defence Secretary's reasoning for making these adjustments; but, since he could agree the figures, he saw no point in attempting to reach agreement on what the proper basis for any such adjustments could be. On the Review Body awards, it had, in fact, never been a principle that the defence budget should be compensated. Mr Nott had accepted that the cost of £33.4 million in 1982/83 could be accommodated within the existing defence budget total. The figures for future years could, in practice, and should, be similarly accommodated.

After discussion, the Prime Minister said it was agreed that the costs of the Review Bodies awards from 1983/84 to 1985/86 should be added to the agreed defence budget totals. The Defence Secretary would, however, withdraw his bid for an allowance totalling some £1 $\frac{3}{4}$ billion over the three years (i.e. line (iii) in paragraph 1 of the annotated agenda) for defence non-pay relative price effect on the understanding that the adequacy of the cash provision was open to review, as last year, in the light of the movement in defence prices. The adjustments set out in paragraph 2 of the annotated agenda should also be made.

There followed discussion of Falklands expenditure. Your Secretary of State recalled that the Government had announced that all the equipment lost in the Falklands conflict would be replaced - not necessarily on a like for like basis - and that these costs, together with the cost of the Falklands campaign and of any future garrison, would be met out of monies in addition to the 3% annual rate of real growth. The best available assessment of the full additional cost of the campaign and of replacing lost equipment in cash terms was £725 million in 1982/83, £223 million in 1983/84, £334 million in 1984/85 and £313 million in 1985/86; a further £365 million (at 1982/83 prices) would be required for the later years. The Chief Secretary proposed that these costs should be re-phased as between the three years 1983/84 to 1985/86 as follows:-

1983/84:	£200 million
1984/85:	£345 million
1985/86:	£325 million

No intention

Your Secretary of State said that he would prefer that the 1983/84 figure should be £213 million: he would consider whether this could be further reduced. ~~W/Note~~ Subsequently you have confirmed that your secretary of State and the Chief Secretary have agreed that firm additions to the defence budget should be made of £200 million in 1983/84, £350 million in 1984/85 and £320 million in 1985/86".

X

On the costs of the Falklands garrison the Secretary of State proposed that the interests of control would be best served by allocating fixed sums and including them in the defence budget. If that was accepted, he would be prepared to argue at OD(FAF) that any additional costs should ~~as far as possible~~ be met from the defence budget. After discussion it was agreed that the sums to be added to the defence budget, at 1982/83 prices, should be 1983/84: £400 million; 1984/85: £300 million; and 1985/86: £200 million. This estimate rested on the assumption of an airfield costing around £220 million and of a configuration of forces on the following lines:

1 SSN
2 Frigates
3 Patrol Craft
1 Ice Patrol Ship
1 Oiler
1 Battalion
6 Phantoms
2 Hercules
3 Chinooks

5 other helicopters
8 Rapier fire units -

with a total onshore strength not exceeding 2,000.

I attach a table summarising the changes to the PESC baseline as a result of these decisions.

At the end of the meeting the Defence Secretary mentioned his plan to purchase four second-hand wide-bodied jets (DC 10 freighters) for mid-air refuelling. He would be obliged to purchase these from the USA, and his intention would be to find as much as possible of the cost of purchase of these aircraft within this year's defence budget total. The costs of conversion were included within the provision of £400 million for the Falklands garrison next year. The Prime Minister noted the considerable operational advantages that this purchase would confer, and agreed that it would be important to bring forward as much of the cost as possible to within this year's expenditure.

~~Last sentence of record deleted~~

I am sending copies of this letter to John Kerr and John Gieve (HM Treasury) and to Richard Hatfield (Cabinet Office).

CONFIDENTIAL

DEFENCE PROGRAMME

	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>
Survey baseline	15277.8	16424.2	17596.3
"Restoration of 3%"	-43.5	46.7	50.2
1982 AFPRB etc awards	42.0	44.1	45.9
Falklands non-garrison	200	350	320
Falklands garrison	424	334	232
Baseline for PEWP	<u>15900.3</u>	<u>17199</u>	<u>18244.4</u>
Change	+622.5	+774.8	+648.1
of which Falklands	+624	+684	+552

CONFIDENTIAL