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To: PRIME MINISTER

22 July 1983

From: JOHN SPARROW

HARM v. ALARM

1. The revised proposal by British Aerospace to reduce the fixed price contract for 750 ALARM missiles by £97m. appears at first sight to simplify the choice confronting the Cabinet on Tuesday. However, this new offer depends upon British Aerospace being able to absorb development and initial production costs of £97m. through additional sales to the RAF and through export orders.

2. The RAF requirement remains at 750 missiles with the possibility of an additional order of 250 missiles if funds are available. The ability of British Aerospace to recoup the £97m. therefore depends critically upon the export potential of ALARM. The paper for Cabinet indicates that export prospects are extremely uncertain, particularly as the revised offer presumably implies a higher unit price for export orders.

3. The likelihood of British Aerospace meeting current budget and delivery targets is remote and, even if the Government keeps British Aerospace to the original fixed price offer, the financial pressures upon the Company are likely to be considerable. If additional RAF sales and significant export orders do not materialise, it is likely that the Government will be forced to meet the £97m. of development and production costs in one form or another.

4. The possibilities include

- consequential effects on other MoD contracts, despite current assurances from British Aerospace;
- launch aid for civilian projects which will be related to the Company's financial situation;

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- loss of dividends to the shareholders with HMG holding 48 per cent of shares;
- loss of cash proceeds from future share disposals.

5. The CPRS believes therefore that the new offer by British Aerospace has wider implications for the Company which the Government as customer, as shareholder, and as Government needs to take into account in making its choice between HARM and ALARM.

6. I am sending a copy of this minute to Sir Robert Armstrong.

TS.