



Prime Minister

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The Chief Secretary proposes for his bilateral with the Defence Secretary

(1) Nothing beyond the 3%

Treasury Chambers, Parliament Street, SW1P 3AG NATO commitment

increase (Falklands-exclusive)

for 1984-5 and 1985-86

(2) No real terms increase
8 September 1983

for 1986-7;

(3) and he reserves the right to go back on (1) if compelled to if the expenditure exercise is going badly.

Rt Hon Michael Heseltine MP
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Ministry of Defence
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MS
Stan Michael

PUBLIC EXPENDITURE SURVEY 1983

At its meeting on 21 July, Cabinet agreed that our objective for this year's Public Expenditure Survey should be to keep to the planning totals for 1984-85 and 1985-86 published in the last White Paper, and to maintain expenditure at about the same level as this in cost terms for 1986-87. We are to meet at 4.30 pm. on 20 September to discuss how your expenditure programme might be adjusted to help in meeting this overall objective in each of the Survey years.

Cabinet is likely to discuss the provision to be made for pay in 1984-85 on 15 September. In the meantime, I suggest we should prepare for our bilateral discussion on the basis that there will be a single standard assumption about pay increases for the Civil Service and related groups, the Armed Forces and the NHS, that it will be rather lower than the 5 per cent and the agreed assumption will, like last year, be removed from all programmes before final decisions are taken.

Our current commitment is to increase defence expenditure by 3% per annum in real terms up to 1985-86. For our discussion I am prepared to take this commitment as our starting point. Defence provision in 1983-84 is £15,715.4 million. On the basis of the cash factors and an assumption that a 3 per cent pay factor is adopted for 1984-85, 3 per cent growth up to 1985-86 (Falklands exclusive) would be met by the following provision:-

	<u>1984-1985</u>	<u>1985-86</u>
£million	16,908.3	17,933.7

I could not agree to any growth in excess of the NATO aim..

The provision above will necessitate reductions in the current cash baseline for defence. This means, of course, that I cannot accept your bids for the first two years. I must also emphasise that the objectives set by Cabinet for the Survey are very stiff ones. If I am unable to make sufficient progress towards these objectives in my round of discussions with colleagues it may be necessary to look again at all programmes, which would mean that for defence I might have to seek a contribution which would lead to provision lower than in paragraph 3 above. But the overall position is unlikely to be clear by the time we meet on 20 September.

You are seeking two further additions for 1986-87 - another year of 3 per cent real growth and provision for extra Falklands costs. For the non-Falklands budget my view, based on the Cabinet's overall objective is that we should not plan for any real growth in 1986-87 or the later years of this Parliament (see the Prime Minister's minute of 5 August). Although I naturally realise that provision must be made for extra Falklands expenditure in 1986-87, my hope is that we can agree a figure substantially below your present bid of £623 million, and in line with Parliamentary and public expectations that the burden of extra Falklands expenditure will continue on a declining trend after the published figure of £684 million for 1984-85 and £552 million for 1985-86.

TPM

Manpower

Our discussion should also cover the civilian manpower aspects of your programme up to 1 April 1988. You have proposed for civilian manpower:

	1/4/84	1/4/85	1/4/86	1/4/87	1/4/87
Baseline	200,000	198,000	197,000	197,000	197,000
Net change		-13,966	-13,926	-14,972	-15,142
Proposed requirement		184,034	183,074	182,028	181,858

As you know, Cabinet agreed on 21 July that we should secure rather larger reductions to the present total than those so far identified by departments. The 1982 PES exercise showed a run-down to 197,000. The Government cannot claim the planned change in status of the Royal Ordnance Factories as a new saving. Without the ROFs the baseline is 178,500, so the present bid adds 3,358. I hope that the development of MINIS and a continued search for savings can produce substantial reductions. You will have your own views on what can be achieved and how, but I would regard a reduction to 170,000 at 1/4/88 as a reasonable initial target at this stage, with an expectation that greater savings will be identified when MINIS becomes fully operational.

Handwritten signatures: G. M. W. and P. Rees

PETER REES

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