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PRIME MINISTER

26 July 1985

MISC 110 REPORT ON DEFENCE R&D

MoD purchases most of its equipment in the most expensive fashion - to its own specifications, from British suppliers. 90% of our equipment is British. Most of it requires heavy R&D investment, whose costs often escalate alarmingly (Torpedos, Nimrod, Radars). This is why £1 of R&D is required to buy £3 of defence equipment production.

MISC 110 has been a delicate exercise. It has used a rather fragile argument, that MoD's pre-emption of so many of the best scientific brains in the country has undermined industry's competitive capacities, to bring MoD to consider reducing R&D. The report suggests that MoD's R&D should progressively be reduced over the next 10 years, in order to make British industry more competitive.

Michael Heseltine's line of defence might be:

1. This will happen anyway, with my collaborative initiative and greater use of competition.

Answer: We can't be sure; development costs on non-competitive contracts can escalate; we need a deliberate limit on defence R&D.

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2. If MoD-funded scientists were released, how could we be sure that they won't just emigrate, or wind up on the dole? Don't we need a "strategy" to ensure that they would make a significant contribution in science-based industry? Indeed, unless there is one, I won't agree to releasing resources.

Answer: Good project leaders in the Defence Research Establishments are in great demand. The establishments have difficulty retaining good people. There is no problem about them being productively employed elsewhere in the economy. We don't need DTI to "direct" or "co-ordinate" their redeployment, or anyone else's. Markets work if they are allowed to, and this is one labour market which does. Defence equipment suppliers can turn their hand to civilian markets if military sales stagnate. Marconi Instruments, for example, which produces simulators for Nimrod aircraft, has now produced and sold simulators to train railway drivers.

The Main Policy Issue

The crunch issue is the industrial policy which underlies MoD procurement. This, as much as the threat, drives up the R&D costs. We insist on designing so much of our own equipment - with a few exceptions, such as ballistic rocketry. Although MoD's competition policy will help to reduce R&D costs, major reductions can only be achieved by buying more equipment collaboratively or off-the-shelf. Table 8 of the

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officials' report shows that off-the-shelf purchase overseas is far more sparing with R&D than other options (a production/-development ratio of 9, 2-3 times higher than on other routes). This would save money, and give us reliable equipment, earlier. Our air defences would not be exposed now, and for some years hence, if - as the Air Force wanted - we had ordered AWACS instead of Nimrod AEW. We can't excel in everything. We don't need to retain many technologies for defence reasons. The 1983 study of this showed that only five are essential to our defence.

DTI are caught on both sides of this argument. In the MISC 110 discussion, they have argued that MoD should reduce R&D expenditure, but, on most equipment decisions, they argue strenuously for the Buy British procurement route which drives the massive R&D spend.

This is an opportunity - perhaps a unique one - to confront DTI with the consequences of their Buy British preference. Do they want so many of the best talents to remain in defence, rather than take on the Japanese in, say, consumer electronics?

We recommend that you attempt to:

1. Sign MH up on the policy to progressively reduce R&D in real terms.

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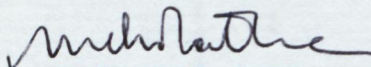
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2. Sign up MH and NT on the need to collaborate more and buy more foreign equipment (whether made overseas or built under licence).

But:

3. Avoid any commitment to switch funds from MoD to DTI. It will take some years to reduce MoD's funds. It would be premature to commit them now.
4. If MH is amenable to these proposals, he should also be encouraged to direct more research to universities, as from now. Defence work takes diverse forms, which need not embarrass academics, nor raise questions of confidentiality. But this suggestion should not be allowed to compromise the main objective - winding down MoD's spend.


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