



10 DOWNING STREET

*From the Private Secretary*

Prime Minister

Mr. Levene is coming  
with MH. The purpose is to  
let you meet him and  
give support to his efforts  
to get better value for money  
from the defence budget.

You will want to ask in  
particular about Nimrod.

Please see note by the  
Policy Unit.

C.D.P. 29/7

PRIME MINISTER

29 July 1985

MEETING WITH PETER LEVENE

You will want to give Peter Levene some encouragement. He has been sniped at from a number of quarters since his appointment. You could remind him how much depends upon his efforts. Few, if any, civil servants can save (or lose) so much. He and Michael Heseltine will be ready enough to let you know how he has set about his task. Some points which you could then raise are:

1. Savings. In evidence to the PAC, PL hinted at savings equal to a "double figure percentage", ie over £800 million after five years on a procurement spend of £8 billion. How confident is he of this figure? How does he derive it?
2. The Procurement Executive. When he was an adviser, PL reported on how the PE could be improved. Now that he is in charge, how is he reforming it? One problem in particular which he identified was that it is not clear who, if anyone, is in charge of major contracts. He suggested project teams. This seems a sensible idea. How is it progressing?
3. How much competition can we expect? The share of new contracts by value which were priced by competition



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rose from 14% in 1979-1980 to 26% in 1984-85 - a good start. How much further scope is there?

4. Over-runs on existing contracts. PL inherited a vast overhang of cost-plus contracts which, if not corralled quickly, could eat up all the savings he might make on new contracts. The Efficiency Unit's recent study on Capital Expenditure Contracts revealed that all the five defence contracts in their sample over-ran on cost by around 50% in real terms (Tigerfish Torpedo, Seabed Operations Vessel, SP70 Howitzer, Foxhunter Radar, Nimrod AEW). They are also late and expose our defences. Our air defence is scarcely credible. The Tornado F2s (introduced in November last year) have been flying with concrete ballast to compensate for the absence of their Foxhunter Radars.

You might ask whether all major contracts with a risk of over-run could be reviewed and renegotiated if necessary. (MOD did a good job recently renegotiating a contract for a battlefield artillery engagement system.)

5. Nimrod AEW. This must be PL's biggest headache at the moment. It is also the biggest defence scandal. MOD have carried out a technical audit, and conclude that we could have a workable system by the end of 1986. It would, however, fall a substantial way short of the

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standard originally contracted for (Air Staff Requirement 400) in that:

- its communications would not be resistant to electronic counter-measures
- it would not work over land
- it could track 160 aircraft, not 400
- it would not have much spare capacity.

One way forward would be to negotiate a fixed price with GEC to finish to this revised standard and invite competition to develop the system further to the original requirement. PL's task is to negotiate a favourable, fixed price, knowing that the alternatives available to us now are not attractive. It would be nice to contract out air defence until the contract is completed, and send the bill to GEC! We could still buy AWACS, but nine AWACS might cost as much as \$2.5 billion and not be available until 3-4 years' time.

You might offer to help PL by finding an opportunity to impress upon Arnold Weinstock that he has let the country down badly. Morally, he ought to complete the

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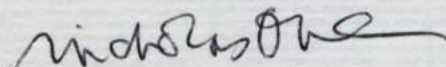


revised contract at GEC's own expense. He would not wish to forfeit a major customer's goodwill.

6. MOD procurement generally. You will be discussing MOD R&D on Wednesday. You could ask PL how we could avoid such heavy defence-related R&D expenditures. Off-the-shelf purchase is the obvious, but unpopular, answer. Michael Heseltine and PL are keen to let industry do more R&D and approach MOD with products which offer original and cheap solutions.

But how will MOD respond when industry does come up with the goods? BAe has developed an anti-tank mortar (Merlin) which is highly effective, because it would penetrate downwards through the vulnerable top of Soviet tanks. But the Army's funds are already committed. So it is difficult to see how adventurous defence contractors can do business with MOD for, whatever the attractions of the offer, funds are already committed to projects which MOD has originated.

You might ask PL if there is not something wrong with MOD's procedures, if they make it difficult to respond to attractive private initiatives.

  
NICHOLAS OWEN

Cardline

CDP  
IVE 30 July  
at 0930.  
CR.

We need to fit in a  
meeting before the end of  
July, with the Defense  
Agency & Peter Levene.  
 $\frac{1}{2}$  an hour is plenty. Can  
you please negotiate a time  
with Mr. Herkline's office.

CM.