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LORD PRESIDENT OF THE COUNCILPUBLIC EXPENDITURE SURVEY

Thank you for your letter of 29th October.

2. The new figures you propose for defence expenditure represent some improvement over those we considered yesterday. But they still fall short of maintaining defence provision level in real terms after 1985/86:

	1985/86	1986/87	1987/88
Cash	18060	18564	18867
Real growth (Falkland-exclusive)			
a. year-on-year	2.8	-0.5	-0.7
b. over 1978/79	18.4	17.8	17.0

To eliminate the shortfall the additional cash required is:

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3. As I indicated in my minute of 24th October the political and international implications of appearing to plan for a real reduction after 1985/86 would be serious. Not only shall I be having to cope with the growing pressure of the build up of Trident costs against a deteriorating exchange rate, which is now widely perceived (including by our own back benchers), but there is also the international pressure led by the US Administration in the face of Congressional demands for a greater European contribution to the burden of Alliance defence. For the British Government to be seen at



this time to be planning a conscious reduction in defence expenditure would be a source of considerable concern. Given that we have come so close to resolving our differences, I cannot believe that a reduction of £94 million on defence set in the context of total public expenditure is worth the disadvantages I have described.

4. The £94 million difference also represents the cash reduction from the figure established in the 1984 PEWP and would therefore be especially difficult to explain as other than a cut. I hope therefore that I can persuade you to let me retain the £94 million and carry it forward to 1987/88. This would leave a difference between us of only some £140 million in 1987/88. Here I would agree to pursue the solution of agreeing a form of words for publication. This has the virtue of assisting the arithmetic of public expenditure while leaving it open to us to make the essential political judgements about defence expenditure in the pre-election period closer to the time.

5. If we are to proceed on this basis we need however to devise a form of words that is less open than your suggestion to any interpretation that the reader wishes to place on it. I propose the following:

The 1985/86 provision is in line with the NATO aim of real annual increases in the region of 3%. Thereafter the intention is to hold defence expenditure broadly level in real terms: the cash provision in 1987/88 will be subject to review in the light of price movements and other relevant factors.

6. I shall even so be accused of cutting the defence budget at a time of mounting Trident costs. I realise that my Cabinet colleagues are taking difficult decisions in their own fields and that perhaps concern about the domestic implications of expenditure reductions in other areas may obscure the international implications

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of reducing defence expenditure which I perceive so clearly. I therefore believe that, in the context of her relationship with President Reagan, the Prime Minister will wish personally to consider the implications of decisions on defence expenditure.

7. I am looking further at the civilian manpower figures and hope to let you have proposals in a day or two.

8. I am copying this minute to the members of MISC 106 and to Sir Robert Armstrong.

Rummm

[Approved by the Defence Secretary

Ministry of Defence & signed in his absence]

30th October 1984