

PERSONAL: *De Nozome*



**CABINET OFFICE**

With the compliments of

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From: J B UNWIN  
14 October 1986

LORD PRESIDENT

**STAR CHAMBER: DEFENCE PROGRAMME**

I think it would probably be sensible to suspend judgement on the defence programme until the Group have reviewed the position on all the outstanding programmes. They will then be able to judge whether to press hard for savings on defence to allow more resources to be allocated to higher priority programmes. It is also a programme on which I imagine you will particularly want to take the Prime Minister's mind before you decide how hard to press.

HANDLING

2. I suggest, therefore, that on this occasion you should keep discussion for the most part at the level of the defence budget as a whole and avoid getting drawn into too many detailed issues. You could start by asking the Chief Secretary to explain why he is looking to defence for savings, and why he believes they can be made without damaging defence capabilities. You could then invite Mr Younger to reply. It would then be very helpful to see how far you can press or lure him into revealing his true position. I think it is very doubtful whether he is seriously pressing his above baseline bids of £131 and £148 million in the first two years; and I am sure he will come down substantially from the bid of £456 million in the last year. He might, for example, be prepared to accept an addition of £292 million, comprising £198 million for the Falklands (on which I frankly think the Treasury are trying it on) plus £94 million for a "1/2 per cent uplift" (ie to meet the 3 per cent GDP deflator rather than the 2 1/2 per cent uplift factor that the Treasury have applied to this and other programmes across the board).

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## ISSUES

3. The following notes deal briefly with the individual issues that might come up.
4. Mr Younger's AFPRB bid (£95, £99 and £102 million) has been made and rejected in previous years. To accept it would be in conflict with the agreement reached by Ministers in May this year that the presumption should be that costs of Review Body awards should be found within existing resources. To accept the bid would weaken the Government's position vis-a-vis Review Bodies.
5. Dockyard pensions bid. This is a case of another rejected bid being resubmitted. The Treasury argue that MOD get the benefit in terms of greater efficiency and should meet the initial costs, bearing in mind that the Treasury are already faced with PSBR costs of up to £200 million to cover transfer of accrued pension rights.
6. 1989-90. This is the real issue this year. Mr Younger argues:-
  - (a) that the Treasury are deducting the Falklands cost twice. They should either stick to the methodology of having a separate Falklands addition or should have created a new baseline by uplifting the Falklands inclusive provision for 1988-89 (which you agreed with Mr Heseltine last year) which subsumes the £142 million of Falklands costs;
  - (b) baselines for 1989-90 were established by increasing 1988-89 figures by 2 1/2 per cent. An extra 1/2 per cent is needed to achieve "level funding" in real terms.
7. The Treasury will argue against this:-

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(a) MOD figures show that the actual cost of Falklands in 1989-90 will be £127 million;

(b) the cost of the Falklands/<sup>is</sup>now down to a level which, given public expenditure pressures, can be absorbed (in addition to a cut of £300 million);

(c) there can be no principle of level funding in real terms. Any settlement must be in cash with no form of commitment to level funding in future;

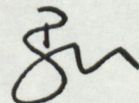
8. As indicated earlier, I am bound to say that I do not think the Treasury case on the Falklands is a fair one. But equally Mr Younger's bid is far beyond anything the Group can reasonably accept.

#### OTHER POINTS

9. You may also like to bear in mind the following points:-

(i) Even with the Chief Secretary's proposed reductions, the Defence Budget will show 17 per cent real increase on 1978-79. Defence as a share of GDP will still exceed that of our richer European allies (4.2 per cent compared with Germans' current 3.3 per cent);

(ii) you will recall the Ministerial decision in E(A) that defence research and development should be cut back. Mr Younger is contesting this, and it was explicitly without prejudice to the overall defence budget. But it remains a relevant consideration.



J B UNWIN

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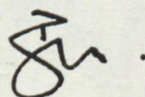
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PS At E(A) this afternoon there was support for advancing the minehunter programme. This would add £3, £11 and £12 million to the defence programme in the three PES years. The Defence Secretary said that he would be prepared to bear some, but not all this extra cost. The Prime Minister ruled that it should be considered further by the Star Chamber in the context of consideration of the defence programme as a whole.

You will therefore need to refer to this also tomorrow. I doubt whether it would make sense to try to earmark some specific amount for this. In practice I suspect that, as and when the Group put an overall proposal to Mr Younger, they will need to be able to claim that a share of the minehunter costs has been taken into account in the numbers they suggest.

The outcome on advancing frigates was not so clear cut. Further consideration will need to be given to this in the light of a more detailed assessment of the prospects for Swan Hunter, including the contingency liability on the Government should they fail. I do not think that this can sensibly be covered at this stage in the Star Chamber discussions.



J B UNWIN