

MR GRAY

24 OCTOBER 1988

1988 PES: DEFENCE

The following are my detailed comments on the settlement reached between the Defence Secretary and the Chief Secretary.

A. BACKGROUND

George Younger himself established the test of acceptability in defence terms for this settlement in his original bidding letter.

In it he set out a list (attached at Annex A) of additions to the programme and existing items with which we could not proceed if funding was constrained to the PES 87 level.

The items on this list (which also shows at what point the EFA opportunity cost comes in) represent, therefore, MoD's assessment of the "necessary minimum" to sustain our current defence policy.

On the basis of the settlement reached MoD should not need to cut into this list at all. Indeed they would only need to take just over half by value of the savings measures identified below to bring the defence programme into line with the new level of resources.

B. THE SETTLEMENT

The bid which George Younger brought to his Brighton discussions with John Major, and the subsequent settlement, are as follows:

£m	1989/90	1990/91	1991/92	Total
MOD Bid	375	767	1,212	2,354
Settlement	100	500	900	1,500
Gap	275	267	312	854

C. BRIDGING THE GAP

The areas which offer real scope for bridging this gap - without cutting items out of the list of equipment bids - are as follows:

(a) Efficiency Savings

At the Prime Minister's Value for Money Seminar in March the MoD said that they had adopted a target of improving efficiency by 2½ per cent a year over the period 1988-89 to 1991-92.

This efficiency programme could go a long way to bridging the gap between the MoD's bid and the final settlement:

- i. The 2½ per cent target is cumulative, yet the MoD bid did not incorporate a further 2½ per cent in 1991-92. The efficiency gains in this year would, therefore, be limited to those carried forward from the previous two years.
- ii. The MoD bid assumed that 45 per cent of these gains for 1991/92 were already built into the defence programme. This does not appear a very convincing figure, given that MoD's own corresponding figures for previous years fall progressively from 100 per cent in 1988/89, to 55 per cent in 1989-90 and about 45 per cent in 1990/91. This would point to a figure of 40 per

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cent or less in 1991/92. One would expect that the further into the future one looked, the fewer efficiency savings would have been identified already and built into the programme.

- iii. MoD have proposed that over the whole PES period two thirds of all the efficiency improvements not already incorporated into the programme should be taken as cash savings and one third as improved output. The Treasury argue that 85 per cent is a more reasonable figure for cash savings given the Prime Minister's view (30 May 1986) that efficiency improvement must continue to make an important contribution towards containing public expenditure.

Taken together these measures would produce further savings over the three year period of:

<u>£20m</u>	<u>£105m</u>	<u>£300m</u>
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(b) Non-efficiency savings

- i. Defence Land and Buildings: In the MoD's six-monthly report to the Prime Minister on "Efficiency in the Defence Field" (6th October) the forecast of disposal receipts were as follows:

	1989/90	1990/91	1991/92
£m	<u>118</u>	<u>90</u>	<u>57</u>

These figures are £52m, £42m and £0m respectively over what was assumed in the MoD's bid.

As Sir Angus Fraser's minute to the Prime Minister (14th October) makes clear a still more stretching target for receipts of £150m per annum (£100m per annum more on average than assumed in the MoD bid) up to 1991/92 should be attainable. As there are 15,300 surplus married quarters (about 19% of the total stock), against MoD's own unmet target to get this figure down to 5,000 by 1988, this objective does not seem unreasonable.

ii. Allowances: the Treasury and MoD have already agreed savings from a review of allowances and from a recent reappraisal of the cost of the local allowance overseas (notably Germany). These savings are worth some £25 million by 1991/92 and were not taken account of in MoD's bid.

iii. Service Charges: An internal MoD audit has shown that charges paid by servicemen for accommodation are £64 million per annum too low. Similarly service messes cost £150 million per annum (a subsidy of £450 per annum for every serving man and women), while only some £7 million is recovered in receipts.

Allowing for the fact that there are limits to the speed at which the MoD could push up charges in the last category, all these non-efficiency savings could yield savings over the three year period of:

£100m £200m £250m

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(c) Carry forward

The MoD bid assumed a carry forward in 1989/90 of £260 million. The MoD now admit to carry forward of £446 million. This would reduce the gap in the first year by £186 million.

(d) R&D

The preceding savings would - in themselves - be enough to close the resource gap comfortably. MOD would, however, have the additional option of seeking savings from R&D. They are required to keep within the R&D ceilings laid down by E(ST). MOD will therefore, have to make reductions of £30m, £80m and £100m just to keep even the defence programme as constrained by PES 87 on track. Further reductions will be required in the light of Mr Younger's additional bids listed in Annex A. In addition MoD will need to take action now to get within the ceiling beyond the PES period in the early to mid 1990s. This could reduce cash flow over the PES period by:

£50m £150m £250m

Drawing all the threads of this rather complicated tapestry together, the overall picture (as regards the savings measures which could be taken without recourse to Mr Younger's list of equipment items) is as follows:

Savings £m	1989/90	1990/91	1991/92	Total
Efficiency	20	105	300	425
Non-Efficiency	100	200	250	550
Carry forward	186	0	0	186
R&D	50	150	250	450
Total Savings	356	455	800	1,611

D. CONCLUSION

This settlement is fair and reasonable.

First, the MoD are not being asked to live within a financial straight-jacket for the next three years.

Under the terms of the settlement MoD will still be able to bid for additional funds over the PES period in the event of a) a Falklands style conflict b) a decision to procure a major item of new equipment for which the requirement could not have been seen at present, c) a significant change in inflationary expectations.

Second, the MoD would only have to take 54 per cent by value of the savings identified in this note to bridge the gap between their bid and the final settlement.

Third, in presentational terms the Prime Minister and the Defence Secretary will be able to point to a return to real growth in the defence budget.

Fourth, MoD will still have a strong incentive to improve the "management of defence".



ANDREW DUNLOP

MOD PROGRAMME BIDS, CUMULATIVE

	1989-90	1990-91	1991-92	LTC TOTAL	
ACE MOBILE FORCE	3.6	12.3	19.5	153.0	
LANCE SUCCESSOR	3.6	12.3	25.3	463.0	
IMPROVED STA	7.4	21.3	42.7	679.3	
TORNADO ADV	9.9	25.9	63.8	820.8	
BUCCANEER REPLACEMENT	11.7	42.7	197.6	1,680.8	
PROCURE TYPE 23-09	16.9	60.8	228.8	1,827.4	
ABBOT REPLACEMENT	16.8	61.7	225.8	1,990.8	
TORNADO GR1	17.7	71.8	262.3	2,247.7	
GUN EQUIP. FOR CHALLENGER	18.0	77.5	274.3	2,270.6	
SEA HARRIER	18.0	78.1	277.1	2,404.5	
HARRIER GR5	30.3	124.1	380.9	2,559.6	EFA OPP COST
PROCURE TYPE 23-16a	30.3	124.8	383.3	2,679.1	
CHEM/BIO WARFARE	34.5	130.9	389.9	2,719.3	
TRITIUM (DUAN)	34.5	134.8	403.5	2,818.0	
BERLIN BRIGADE	35.7	138.5	409.9	2,867.5	
ADVANCE AMRAAM	36.2	135.6	414.4	3,078.7	
SINGLE-ROLE MINEHUNTER	36.3	136.0	417.2	3,178.9	
51mm MORTAR	36.3	143.0	424.4	3,225.8	
ARMY AMMO TO 90%	66.8	215.7	502.4	3,385.8	
PROCURE SUB SSK-05	70.4	222.3	519.3	3,498.5	
RN/RAF SEA EAGLE MLU	70.4	222.3	519.4	3,536.1	
DFWES	75.8	232.2	534.1	3,537.8	
8 BUOY MONITORING	76.3	237.4	541.1	3,555.4	
LASER WARNING RECEIVER	76.5	239.8	546.4	3,600.2	
GURKHA FIELD ENGINEER	76.5	239.9	550.7	3,616.5	
HMS CHALLENGER	86.4	250.5	569.2	3,682.9	
INFORMATION TECHNOLOGY	86.4	289.9	614.4	3,939.9	
HMS ONSLAUGHT	87.5	300.6	625.6	3,965.4	
SKYNET 5	88.7	301.8	631.5	4,083.3	
NON-NUC RESEARCH PROG	92.1	305.2	635.0	4,096.5	
HMS ODIN	94.4	309.7	639.9	4,111.7	
GIBRALTAR INFANTRY	94.4	309.7	655.0	4,202.7	
AVIATION SUPPORT SHIP	96.2	322.1	670.2	4,203.4	