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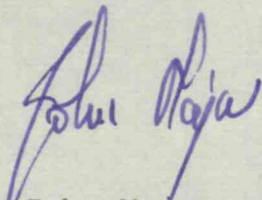
PRIME MINISTERPUBLIC EXPENDITURE SURVEY: DEFENCE

1. This joint minute reports the agreed outcome of discussions between us on the Public Expenditure Survey which we can commend to you.
2. PES 88 began, as we had agreed last year, with costings of two levels of defence programme: one affordable within the PES 87 control totals and the other the minimum programme which the Defence Secretary believes would sustain Government policy as we have presented it. Our starting bids were a long way apart: but we have now agreed, subject to your acceptance, on additions to the baseline of £100 million in 1989/90, £500 million in 1990/91 and £900 million in 1991/92. This is a three-year settlement, not to be re-opened unless there is a significant change in economic conditions particularly in inflationary expectations or a major unforeseen burden on the defence programme.
3. The figures can be presented positively to public opinion and to our Allies. On the July inflation forecast, over the three years as a whole there is real growth of 2.2% in GDP deflator terms and 0.9% in defence-specific terms (this latter figure is not published in the Public Expenditure White Paper). A year ago, the equivalent figures for PES 87 were minus 2.1% and minus 4.0%. Defence expenditure in 1991/92 will now stand at 4% of GDP on present FSBR forecasts of GDP as compared with 4.1% in PES 87.
4. In the light of this settlement, the Defence Secretary will have to look afresh at the content of his forward programme and some

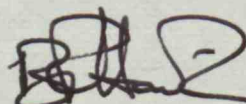


politically-difficult programme decisions may now have to be faced. This will be done over the next 4 months in the course of his next Long Term Costing. He will however strive - particularly by driving forward his Department's wide-ranging efficiency effort - to keep political and financial risk to the minimum. The Defence Secretary will report the details to you in due course.

5. We are sending a copy of this minute to Sir Robin Butler.


John Major

24th October 1988

 P.S.
for George Younger

(Approved by the Defence Secretary and signed in his absence.)