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Jim Morrison

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PRIME MINISTER

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PUBLIC EXPENDITURE SURVEY: DEFENCE

Norman Lamont and I have now concluded our negotiations on Defence in the Public Expenditure Survey and we have agreed that I should report the outcome to you.

2. I, of course, have recognised the difficult situation this year, especially over inflation, and the importance for Norman in the case of Defence of avoiding re-opening, on inflation grounds, the three-year settlement which our predecessors agreed last year.
3. Against this, I have very real problems in meeting the extra cash costs from higher inflation without any visible cuts in the defence programme. I also am having to increase investment in security as a result of Mill Hill and Deal, as well as in measures to tackle the serious retention and recruitment problems we have to face.
4. To meet these twin challenges, we have agreed as follows. First, this year's settlement sticks as closely as possible to the PES 88 outcome. It rolls forward the three-year arrangement, with a further £750M in 1992/3. While on current inflation projections, we shall have growth in defence provision of just over 1 per cent a year on average, this will, of course, be eroded if inflation projections increase in the Autumn Statement. The defence percentage of GDP will be 3.8 per cent, as against the 4 per cent predicted last year, which we shall claim as a steady state in support of our international posture, particularly in regard to CFE.



5. Second, to assist the more efficient use of resources we are adding some flexibility in the use of the agreed provision. Overall provision for 1990/1 remains unchanged, but within it we have agreed an increase of £236M in the running cost limit (to be increased, as necessary, for AWE) to give me more latitude in the use of the cash. For 1991/2, we have reprofiled technical additions due to the MOD over a number of years to provide an increase of £215M. This directs cash to a year of particular difficulty but does so in a way consistent with the three-year agreement reached last year. We have also agreed that, in certain specified circumstances, up to £200M could, in subsequent PES settlements, be carried back from 1992/3 to 1991/2. To get the best out of our capital spending and procurement, we are discussing the application to Defence of the normal end-year flexibility arrangements for capital provision.

6. Third, we have again sought to maximise the benefits of efficiency savings both from the main efficiency scheme itself and from the sustained improvement of our procurement processes.

7. The problem here is to translate this settlement into programme terms. (I am having the precise implications examined in my current long-term costing.) There will have to be changes from the programme planned last year; some are likely to be painful, affecting the front line. I shall, of course, do my best to minimise the damage to capability and too visible an exposure of the changes to allies and public. I shall report the results to you in due course.

8. I am grateful to Norman for his understanding. What we have agreed is not going to be easy, but I accept it as the necessary basis on which to proceed.

9. I am copying this minute to Norman Lamont and to Sir Robin Butler.

[Handwritten signature] (Private Secretary)
for Mr King
T K
(Approved by the Defence Secretary
and signed in his absence on duty)



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