

MR COLES13 December 1983THE RISING COSTS OF DEFENCE PROCUREMENT

The Secretary of State's paper reminds us that individual items of defence equipment cost several times more in real terms than their predecessors. This is not an unusual phenomenon. It happens in industry all the time.

However, advances in technology reduce unit costs in defence as elsewhere. Guided weapons achieve more hits at less cost than the systems they replaced. New technology is only introduced if it is more cost-effective.

The Growth of the Threat

The real problem in defence is the growth of the threat, rather than the cost of technology.

Is this trend likely to continue? The paper tells us that the Russians are also experiencing real cost growth and that 14-16 per cent of GDP is devoted to military expenditure. Is this a sustainable position?

Do we know enough about the threat? Recent statements by the CIA seem to indicate that NATO may have over-estimated the levels of Soviet expenditure. Does this have any lessons for our levels of expenditure?

If defence expenditure in NATO is now roughly equal to that in the Warsaw Pact, why is the military balance so much in their favour? How much is this due to greater value for money through long production runs, to cheaper manpower or to a different trade-off between quantity and quality?

The paper tells us that NATO has little choice but to counter the Warsaw Pact's improvements. But if we are never going to be in a position to stop the Warsaw Pact winning a conventional conflict, is such expenditure always cost-effective?

Value for Money

The Warsaw Pact appear to get more equipment for their money than we do, through standardisation. The paper refers to the long production runs and economies of scale which we are unable to match. Why isn't NATO able to achieve even a modest degree of standardisation in major weapons systems?

Even without standardisation we would still expect our market economy to be more efficient than the centrally-planned approach of the Warsaw Pact. It is ironic that the UK in particular and NATO in general fail to exploit the benefits of competition in the one area where our market philosophy should assist us most in our defence against the Soviet threat.

Foreign competition is excluded from serious consideration in the paper. Although we applaud the Secretary of State's initiatives to encourage competition within the UK, the scale of defence industries is such that effective competition needs to be on an international basis.

Similarly, we need to address some of the intrinsic problems associated with collaborative projects. The major procurement decision in the next few years will be the agile combat aircraft. Collaboration is likely to be the preferred approach although we should not rule out the option of a foreign purchase. (Tornado probably cost twice as much as an F16, even allowing for hidden R&D costs and differences in capacity.) If we do decide on a collaborative project, we must ensure that the potential benefits of a European or possibly American collaboration are realised.

Recommendation

The Ministry of Defence are introducing a series of measures to improve value for money in the equipment budget. The Secretary of State is exerting strong pressure to ensure that these reforms are carried through.

Nevertheless, the seemingly inexorable rise in the equipment budget points to the need for more radical options.

Following the HARM v ALARM decision, an interdepartmental Group with No 10 representation has been identifying those technologies in which an indigenous capability is essential for defence purposes. Our final report is currently with the Secretary of State and should be circulated soon. A short and clearly defined list of essential technologies will be an important development for future procurement decisions.

In view of this outcome, we suggest that a similar small interdepartmental Group should then be asked to consider two further questions:

- would not a more open system of defence procurement for non-essential technologies lead to better value for money for the defence equipment budget?
- what is the scope for achieving greater collaboration and standardisation within NATO?

We anticipate that the Secretary of State for Defence will advise that these questions are not new and are under continuous review. However, by assessing them together, by comparing the experiences of the Warsaw Pact and by looking at future prospects over a reasonably long time horizon, it should be possible to form a clearer idea of where Britain's best interests lie and how value for money in the defence equipment budget could be improved.

#### Co-ordination of Procurement Decisions

The covering note to the Secretary of State's paper also refers to the question of the co-ordination of Ministerial decisions on defence procurement. We suggest that it would be helpful for No 10 to receive copies of the Defence Equipment Policy Committee (DEPC) review of business expected in the following three months, and for the Policy Unit to attend DEPC as appropriate.

DLP.

DAVID PASCALL

E.R.  
PRIME MINISTER

Rising Cost of Defence Equipment

You wished to discuss with the Defence Secretary his Private Secretary's letter of 22 September, the attached paper and the questions in my minute of 4 October.

I also attach a new paper by the Policy Unit.

A.J.C.

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