

MO 8/2/12

*Understand F.P. will be  
sent C.H..*

*MS.*

CHANCELLOR OF THE EXCHEQUERDEFENCE EXPENDITURE 1980/81

I have been considering urgently the points put to me at the meeting held by the Prime Minister yesterday afternoon.

2. The proposition put forward was the defence cash limit should be increased by only £100M net - this would allow for a deduction of some £50M because of cash overspending in 1979/80. This would imply on the basis of present forecasts that I would need to reduce the programme by £300M. This would bring real growth down to below 1% as against the 3% aim. This reduction would be additional to the cuts in volume of £250M I have already made in the first 3 months of this financial year and others which I am likely to make to keep within my volume programme.

3. I know full well the economic problems which currently face the country as a whole and I am anxious to be as helpful as possible. Having looked again with the Chiefs of Staff at the programme I am reinforced in my view that your proposition if accepted would do great damage to our Defence effort, to relations with our Allies, to industry and to the confidence the Services have in the Government. I think too much is being asked of me and I need a little more help than is being proposed. If you for your part were prepared to accept that we should adjust the "fine" to take account of the fact that a significant part of my overspend arose from circumstances entirely outside our control (the loss of receipts from Iran) and that we must adopt a figure the consequences of which are defensible in terms of our public commitments to our Allies and to the Services themselves, I should myself be prepared to agree that in present economic circumstances we cannot fulfil in full the 3% aim for the present financial year. What I have in mind is that we should plan on the basis of an uplift of about £210M net to which would be added the small sum needed to meet a fine on the revised basis now proposed. A settlement on these lines would mean that I

would be accepting a volume squeeze of the sort anticipated at the time of the Budget in spite of our recognition then that defence was a special case. We should need to make clear that our failure to meet the 3% aim this year did not mean that we were not going to do so in future years. h

4. A settlement on this basis would still involve significant and damaging adjustments to the Defence Programme in the current year when taken alongside the measures needed to rein back on volume. I cannot tell you in detail what steps I shall have to take because they will have to be worked out and we shall have to talk to industry. I shall want to rein back our payments to industry and possibly introduce for our major contractors a monthly payments scheme. This may need to be imposed because of industry's cash flow problems which are a primary cause of defence problems. We shall have to go in a substantial way into the Services "activity" areas - this is not over-calling the hand, it is unavoidable. Exercises, training, sea-time and flying will all have to be curtailed and in some cases stopped. I am even having to consider extending the tour of units in Northern Ireland because we shall not be able to afford to bring them back this year, and whether we should cancel our major, and well publicised, NATO exercise Crusader 80. The cuts will go deep and cannot be concealed.

5. I can understand that you will want to make an announcement about cash limits this week. Presentation will be all important and it is essential that it should be low key. But complimentary to your announcement however, I should have to make public that I was reviewing the progress of expenditure on the defence programme and that the following decisions were likely to be necessary:

a. a moratorium, initially for 3 months, on the placing of new defence contracts (save for a few essential exceptions);

b. a decision not to proceed now with the purchase of either the Jetstream or the Beech aircraft;

c. a decision not to proceed with the purchase of 10 Sea Harrier aircraft;

d. a decision to delay the introduction of the scheme we have already approved for Assisted House Purchase for the Services;

e. a decision to continue the freeze on civil service recruitment for a further 3 month period though I would say that we intended to recruit 1800 apprentices (as compared with 2400 last year).

6. I think we recognise that we are having to take hard decisions now on the basis of incomplete information after only one Quarters' financial results. Given all the uncertainties, I hope you will find it possible to agree that the best broad compromise between the conflicting demands of policy would be to increase my cash limit as proposed in my third paragraph. Advice will have to be given to the Cabinet on Thursday and I should therefore be grateful for very early word.

7. I am sending copies of this minute to the Prime Minister; and to Sir Robert Armstrong.

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Ministry of Defence

5th August 1980