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Copied to
Egypt: Defence Sales
Defence

PRIME MINISTER

Defence Sales
(OD(80) 70, 71 and 73)

BACKGROUND

This Note by the Secretary of State for Defence has been circulated in response to your request following your speech at the Flying Display dinner on 3rd September about the need to increase defence sales. In particular you wanted to know what could be done to reconcile more effectively than hitherto the requirements of our own Services for equipment with the simpler needs of many of our potential customers, in order to make our weapons more attractive in overseas markets.

2. The Note by the Chancellor of the Exchequer emphasises a point made in the Secretary of State for Defence's Note about the need to enhance the export potential of United Kingdom defence equipment by thinking more carefully about this factor when deciding our own operational requirements.

3. The Secretary of State for Industry's Note welcomes the proposals in the Secretary of State for Defence's Note but doubts if they are sufficiently radical to achieve the objectives of making defence sales a major contributor to the export efforts of our high technology industries. He suggests in particular more defence sales-related Ministerial visits, more financial support for defence sales, more consideration of export potential in selecting our own defence equipment, 'token' purchases of defence equipment by the armed services to show confidence in United Kingdom manufacturers, and the linkage of defence sales with an undertaking to provide British oil at commercial prices in times of shortage. The Secretary of State for Energy will probably be writing to suggest that this last point should be considered by the Ministerial Committee on Exports rather than by OD as it links up with wider oil export questions. He did not wish to come to the OD meeting.

4. Mr. Ibbs in his minute of 28th November has drawn your attention to the inadequate sales return on MOD R & D. He will be present at the meeting.



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5. The Secretary of State for Defence's Note does not give very much in the way of facts and figures. I therefore attach to this brief two Annexes which set out our achievements in defence sales over the last three years at constant prices by geographical areas and by the main categories of equipment. One of the facts which emerges from Annex B is the very hard knock which our defence sales have taken from the loss of the Iranian market since 1977/78. Over the same period our defence sales to Egypt, which were financed largely by Saudi Arabia, have also tailed away following the Camp David negotiations. Before these two markets diminished our defence sales were doing significantly better than those of the French; and our defence salesmen still regard the Middle East as their most promising field.

6. A factor which the Secretary of State for Defence does not mention in his Note is the organisation for Defence Sales within the Ministry of Defence. This consists of three main elements: the Defence Sales Organisation itself, which is an integral part of the Ministry of Defence; the Royal Ordnance Factories, which do a certain amount of direct selling to customers themselves and would like to do more so that they could retain all the profits for their Trading Fund; and International Military Sales, a limited liability company entirely owned by the Secretary of State for Defence, which seeks to operate as a commercial organisation but has rather a troubled relationship with the Royal Ordnance Factories, the Defence Sales Organisation and the Ministry of Defence in general. Part of the reason for the French success in the defence sales field, as is clearly illustrated in the story of how they sold their Alphajet to Egypt of which the Secretary of State for Defence sent you a description attached to his minute of 25th November, lies in the fact that they have developed a more successful selling organisation than we have got at present.

7. In his reference to foreign policy constraints, the Secretary of State for Defence ignores one real difficulty which besets a country like Britain which lacks a bipartisan attitude to defence sales. Defence orders tend to have long lead-times (and to depend on continuity of supply e.g. for spares and ammunition) and some of our potential customers are bound to ask themselves whether they



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could trust us not to cancel export orders if Labour returned to power. This may suggest that our main sales effort should be concentrated on the comparatively stable and democratic countries of the Western world.

8. But sales to the Western world, and particularly to NATO, depend on progress towards standardisation. To the extent that we each try to make everything there will be fewer export openings for any of us. Collaborative projects may sometimes be the answer, but not if they serve to push up the cost of equipment through attempts to incorporate the separate requirements of each country involved. Specialisation may be another answer, but will not be popular with the Ministry of Defence - who are for example at present working out what tank we want for the 1990s and would not take kindly any suggestion that we should simply buy whatever the Germans produce, even though the two armies are designed to fight the same war on the same battlefield.

9. This reinforces the general point in your September speech, that behind the problem of defence sales policy there lies a much larger problem of defence procurement policy. The present meeting will not offer scope for examining the larger problem in depth. But it may usefully provide openings for ensuring that it is at least identified.

HANDLING

10. You will wish to ask the Secretary of State for Defence to introduce his paper. You may then care to ask the Chancellor of the Exchequer to introduce his Note which will concentrate attention on the factor identified at paragraph 2e of the Secretary of State for Defence's Note about the export potential of Service equipment. You may then care to ask the Secretary of State for Industry to introduce his paper. Points to cover in subsequent discussion are:-

- (a) Does the Secretary of State for Defence consider that we have got a sufficiently effective defence sales organisation and long term marketing strategy both in terms of geographical areas and in terms of the equipments which will constitute the major defence sales in the

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future? Inevitably there is an element of opportunism in this field but particularly if operational requirements are going to be slanted more towards export potential, do we give sufficient thought to the nature and whereabouts of our future defence sales markets?

- (b) Does the Secretary of State for Defence agree that defence sales would benefit from more "fixed price" or incentive rather than "cost plus" contracts as the Chancellor of the Exchequer suggests?
- (c) Do the Secretary of State for Defence and the Foreign and Commonwealth Secretary agree that a more carefully planned programme of Ministerial visits (paragraph 4 of the Secretary of State for Industry's Note) would help to suggest defence sales e. g. in the case of Rapier in Japan?
- (d) Does the Secretary of State for Defence consider that the financial benefits to be obtained justify the Secretary of State for Industry's suggestion in paragraphs 5 and 7 of his Note that a study should be made of whether the Defence Budget should in effect subsidise defence sales by waiving the Commercial Exploitation Levy, and associated levy on Royal Ordnance Factories, and making token purchases of unwanted United Kingdom defence equipment to provide support for British manufacturers?
- (e) Do the Secretary of State for Defence and the Foreign and Commonwealth Secretary consider it possible to reconcile the desirable aims of increased collaboration with our NATO partners in order to achieve cheaper and more standardised equipment, with the limitation on our freedom to achieve defence sales which appear to flow from collaboration? Does specialisation as recently suggested to you by Chancellor Schmidt (all tanks to be made in Germany, all fighters in Britain) offer a more hopeful route than collaborative ventures?
- (f) Does the Foreign and Commonwealth Secretary agree with the Secretary of State for Defence's suggestion that defence sales suffer from foreign policy constraints? Should defence sales endeavours be more frequently and directly supported by Ministerial visits abroad?



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- (g) Does the Foreign and Commonwealth Secretary believe there is scope for relaxing security constraints such as COCOM rules in order to assist defence sales overseas?
- (h) Does the Secretary of State for Industry agree with the Secretary of State for Defence's assessment of industrial attitudes in regard to defence sales? Does industry feel that the Ministry of Defence's procurement procedures are a genuine obstacle or is this merely an excuse?
- (i) Does the Secretary of State for Industry agree that there is scope for closer collaboration with industry at the start of the design stage of a project?
- (j) Does the Secretary of State for Industry agree that (subject to what the Secretary of State for Energy says in his expected letter) the question of relating British oil to defence sales should be considered by the Ministerial Committee on Exports?
- (k) Does the Secretary of State for Trade agree that in the field of defence sales overseas the Chancellor of the Exchequer is right in saying that the problem of producing and selling the right goods at the right price is mainly for industry? He may take the view that in many parts of the world major defence sales can only be achieved on a government to government basis.
- (l) Do the Secretary of State for Trade and the Chancellor of the Exchequer agree that there is scope for improving the credit arrangements for defence sales, to allow our salesmen to take more initiatives rather than trailing the competition?

CONCLUSION

11. Subject to the discussion the Committee might be guided:-
- (i) to note the work already in hand which is described in the Secretary of State for Defence's Note;
- (ii) to agree the further steps proposed in paragraphs 8 and 9 of the Secretary of State for Defence's paper;



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- (iii) to agree the Secretary of State for Defence's proposals to give greater Ministerial impetus to sales set out in paragraphs 3 and 10 of his Note;
- (iv) subject to the Secretary of State for Defence's views, to invite him to consider the scope for modifying specifications and procurement procedures and the form of contract as proposed by the Chancellor of the Exchequer in OD(80) 71;
- (v) to agree that the Secretary of State for Industry, the Chancellor of the Exchequer and the Secretary of State for Defence should discuss whether and how defence sales might be stimulated by a relaxation of current financial constraints;
- (vi) to agree that the support of defence sales should be one of the primary aims of Ministerial visits overseas, and to invite the Secretary of State for Defence to propose procedures for achieving this aim;
- (vii) to agree that the merits of establishing a link between oil exports and defence sales should be considered by the Ministerial Committee on Exports;
- (viii) to identify defence procurement policy as a major field for further Ministerial examination.

(Robert Armstrong)

2nd December 1980

MAJOR DEFENCE SALES IN £M BY TYPE

	AFVs & PARTS	COMBAT AIRCRAFT	MILITARY NON-COMBAT AIRCRAFT	MILITARY AIRCRAFT NOT NEWLY BUILT	WARSHIPS INCLUD HOVER-CRAFT	GUNS & SMALL ARMS etc	GUIDED WEAPONS & MISSILES	AMMU-NITION	RADIO & RADAR	OPTICAL EQUIP-MENT	MISC CONSTRUCTION, ENGINEERING, EQUIP, etc	TOTAL
1977/78	48	711	174	0	373	35	82	171	76	17	648	2335
1978/79	87	1169	71	0	68	24	134	190	44	2	380	2169
1979/80	430	203	63	0	63	44	17	55	147	21	108	1151
Totals	565	2083	308	0	504	103	233	416	267	40	1136	5655

The above figures show orders received during the year at prices obtaining in the 2nd quarter of 1980.

MAJOR DEFENCE SALES IN \$M BY AREA

	NATO & OTHER WESTERN COUNTRIES	MIDDLE EAST & N AFRICAN COUNTRIES	SUB-SAHARAN AFRICA	LATIN AMERICA & CARIBBEAN COUNTRIES	ASIA AND FAR EAST	TOTAL
1977/78	272	1,898	77	33	55	2335
1978/79	195	642	72	22	1,238	2169
1979/80	187	771	27	76	90	1151
Totals	654	3,311	176	131	1,383	5655

The above figures show orders received during the year at prices obtaining in the
...2nd quarter of 1980.

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The Rt Hon Sir Keith Joseph Bt MP
Secretary of State
for Industry
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2 December 1980

Dear Keith

I have read with interest your note on defence sales (OD(80)73) and noted the suggestion in paragraph 8 that British oil be used to assist arms sales.

EX on Thursday will be considering, amongst other matters, the possible use of our oil to promote exports. We have very little oil surplus to our own security requirements. Use of any surplus for trade promotion therefore requires careful co-ordination. You may feel this co-ordination is best achieved through EX and that it would be proper for that Committee to consider your note.

I am sending a copy of this letter to our colleagues in EX and OD and to Sir Robert Armstrong.

D A R HOWELL

*Yours
Darius*