

Ann Christie

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Further notes on the points
you raised are in his
file.

T 05373

PRIME MINISTERDefence Estimates 1981/82Meeting on Wednesday 31 December at 3 pm

You are due to have a meeting on Wednesday 31 December to discuss the Defence Secretary's minute to you on this subject of 23 December. In addition to the Defence Secretary, the Foreign and Commonwealth Secretary, ^{another Chancellor} ~~a Treasury Minister~~ and ~~an Industry Minister (probably Mr Adam Butler)~~ will be present.

BACKGROUND

2. In his minute the Defence Secretary reports that the Defence Programme planned for 1981/82 is being seriously affected by two factors. These are:-
 - a. Industrial production of defence equipment has improved to such an extent that an additional £360 million has got to be found to pay for equipment in that year which is being delivered earlier than anticipated in previous plans.
 - b. The decision by the Cabinet in November which required a cut of £200 million to be made in the planned 1981/82 programme.
3. In addition to these two factors, the problem is likely to be aggravated if an overspend of the cash limit in the current year has to be recovered in 1981/82. This might amount to a further several hundred million pounds, but a precise figure will not be available until the end of the current financial year.
4. Lastly past experience suggests that the defence cash limit for 1981/82 may prove to be less than adequate, involving a hidden squeeze on the total size of the programme. But at present the Treasury believe that the proposed Defence cash limit for 1981/82 should be sufficient.
5. The Defence Secretary's minute is only concerned at this stage with the difficulties at a. and b. The sums involved are approximately 5 per cent of the planned 1981/82 defence budget for which the 1981 Survey baseline was £9947 million at 1980 Survey prices.

6. Apart from making you aware of the Defence Budget problem in 1981/82 it seems likely that one of the main aims of the Defence Secretary's minute is to seek views on the best way of making public to NATO and to Parliament the nature of the difficult decisions which have got to be taken, particularly those set out in Annex B to his minute. But you may feel that these difficulties are exaggerated and that there is insufficient recognition of the fact that the Services are being steadily better equipped and better manned, even during a period of economic depression.

HANDLING

7. You will wish to ask the Secretary of State for Defence to introduce his minute. The subsequent discussion might cover the following points:-
- a. Why does the Ministry of Defence find it so difficult to identify programme reductions of £360 million because of improvements in industrial production? Reductions of this amount have only become necessary because at an earlier stage it was assumed that there was going to be a shortfall of this amount on the programme anyhow. Surely it is better to identify those elements in the programme which the Ministry of Defence wish to defer than simply allow the process of deferment to happen by chance? The problem the Defence Programme faces here is one of management rather than of financial pressure. If it is handled properly, it must represent an improvement over the situation which always arose in the past when some deliveries were simply not made on time.
 - b. From a presentational point of view, cannot the Defence Secretary get much credit from the early deliveries which are giving rise to the need to find the additional £360 million? This is both a success story for British industry and good news for the Defence Programme if it means that newer equipment is coming into service more quickly than has been the case in the past. It must be better for example to sell or scrap five Tribal class frigates which are nearly 20 years old to make room for new warships and aircraft which are coming into service earlier than had been anticipated? These old ships must have been due to be scrapped shortly anyhow.
 - c. Does the Foreign and Commonwealth Secretary believe that the situation can be presented in these positive terms to our NATO allies? Is it necessary in any case to make any formal announcement of a number of the programme adjustments which are identified in Annex A? Many of these items are the kind of adjustments which are taking place all the time for a variety of

technical and administrative reasons.

- d. Does the Defence Secretary feel that the emergence of the need to find £360 million because of the improvement in industrial production suggest that the Ministry of Defence's control of its cash flow ought to be improved? The present situation seems to suggest that there is insufficient control built into present procurement procedures.
- e. How does the Department of Industry regard the proposed reduction identified in Annex A and B? To the extent that the £360 million was not due to go to British industry in this period anyhow, does it really matter if it is taken from them in the form of the measures that are identified at Annex A and B rather than in the form of the traditional shortfalls which could not be identified in advance?
- f. Recognising that the apparent need to find specific programme reduction of £360 million in the 1981/82 Defence Programme does not really represent a reduction in the amount of money available for defence equipment, is it agreed that there is no reason for reconsidering the Cabinet's decision to cut that programme by £200 million as agreed last November.
- g. Turning to the likely overspend in 1980/81 and the need to cover it in 1981/82, have the Defence Secretary and Chancellor of the Exchequer got any idea yet of a likely figure? Is any consequential reduction in the 1981/82 programme likely to give rise to particular presentational problems in the light of the fact that taking 1980/81 and 1981/82 together, the amount spent on defence remains unchanged?

CONCLUSION

8. Some of the measures identified in Annex B to the Defence Secretary's minute will almost certainly have been put forward by the Chiefs of Staff to make the flesh creep. Although you will wish to give the Defence Secretary every support, particularly in view of their current disgruntlement, you may care to emphasise that the only real reduction which has been made on the Defence Programme planned for 1981/82 is the £200 million which the Cabinet have agreed should be cut. There are no other real reductions. The £360 million problem should be solvable by a more

flexible managerial approach. The Defence Programme never had that money to spend and were indeed never expecting to spend it. Any recovery of the cash limit overspend in 1981/82 is balanced by the additional expenditure and the goods received for it which will have taken place in 1980/81. Constant adjustments are necessary in any large programme. Both in NATO and in Parliament the adjustments which the Defence Secretary is being required to make must be kept in the proper perspective of the rising defence programme which the United Kingdom is undertaking, in accordance with the Government's commitment to NATO and electoral promises. Highly visible cuts like the disbandment of 41 Commando Royal Marines should be avoided if possible. Savings should be made by deferments rather than cancellations, continuing pressure on the 'tail', and taking old ships and equipment out of service. Attention should be concentrated in public and in NATO on the very real improvements which are being made. The Chiefs of Staff should be encouraged to count their blessings.

R.M. Hastie-Smith

Cabinet Office
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R M HASTIE-SMITH