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From the Principal Private Secretary

19 January 1981

Dear Baron,

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Defence Expenditure and BAe Flotation

The Prime Minister held a meeting this afternoon with your Secretary of State, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Industry and the Attorney General to consider both the proposal made by Mr. Nott in his minute of 16 January 1981 that he should make a statement tomorrow about cuts in defence expenditure in 1981/82 and the question of the flotation of British Aerospace on which recent Ministerial correspondence rested with Sir Keith Joseph's minute of 19 January. Sir Robert Armstrong was also present.

The Defence Secretary said that he was seeking cuts which in all would total £850m. in 1981/82. Of this figure £200m. was the saving agreed by Cabinet in November; the remaining £650m., which would not be mentioned in any Parliamentary statement, was the reduction necessary to bring the programme back into line with the original PESC provision for next year. He had reviewed the measures which his predecessor had been considering and as he had explained in his minute, he had concluded that he could find only £160m. of the £200m. cut agreed by Cabinet. The changes in the programme which this reduction required reflected the Chiefs of Staff priorities. He was not happy about the merger of No. 41 RM Commando with other Commandos, but Mr. Peter Rees was ready to go along with the amalgamation, provided the RM Music School remained at Deal. He did not see how he could find the remaining saving of £40m. without adopting measures which would have a very damaging effect on the defence industries.

Mr. Nott continued that he would like to make his statement the following day. He saw every reason politically for getting the announcement about defence expenditure next year out of the way as quickly as possible. It would be no easier to make it in a month's time. Indeed if it were delayed until just before or just after the Prime Minister's visit to Washington, this would be more embarrassing than doing it now. Moreover, once decisions about next year were announced he could get down to the much greater problem of the defence programme in the medium term. He should not conceal from his colleagues, however, the fact that he would

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have to reveal in answer to supplementary questions that a considerable number of jobs would be lost as a result of the present cuts in the defence programme. Yarrows, Vosper Thorneycroft and Scott Lithgow would survive, but he expected Cammell Laird to close. About 6-7,000 job opportunities would be lost in the shipbuilding industry.

The Foreign and Commonwealth Secretary said that he did not believe that it would matter much if Mr. Nott made his statement on the day President Reagan was inaugurated; and in further discussion it was agreed that the Defence Secretary should go ahead as he proposed tomorrow.

The meeting then considered the draft statement in the light of the proposal to float British Aerospace in February. The Attorney General said that it was essential that the Defence Secretary's statement and the flotation prospectus should provide a proper understanding of our intentions in the defence field as they affected BAe. The Secretary of State for Industry said that with this general requirement in mind, he would like to see the draft statement amended in the way he had proposed in the minute which he had circulated today. First, he thought that the position on Sea Eagle should be explained more candidly than was done in paragraph 4 of the draft statement. Second, he did not think the second sentence of paragraph 8 explained explicitly enough for flotation purposes the decisions taken by Cabinet about defence expenditure in 1982/82 and 1983/84. Lastly, the fourth sentence of paragraph 8 suggested a much less radical review of the defence programme than the Defence Secretary's minute implied. In discussion it was agreed that:-

(a) The sentence about Sea Eagle in paragraph 4 of the draft statement should be amended to read:- "The Sea Eagle anti-ship missile will continue although further consideration will be needed before its place in the programme can be confirmed".

(b) The second sentence of paragraph 8 should be amended to make it clear that the reduction of £200m. in 1981/82 was carried through into the two following years, and in any case the words "defence expenditure" should be substituted for "resources". It was also desirable not to give unnecessary emphasis to the NATO commitment of 3% annual growth in real terms, now that General Haig and Mr. Weinberger were showing signs of playing down the significance of the commitment. If the Defence Secretary was asked in supplementaries whether the Government remained committed to annual increases of 3%, he should reply on the lines that the NATO commitment was clear and the Government had made plain that it abided by it.

(c) The fourth sentence of paragraph 8 should read "...is wide of the mark; but we must, over the next year, look realistically at our programmes to match them to the resources likely to be available".

/In subsequent

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In subsequent consideration of the draft statement it was agreed that the opening three or four sentences of paragraph 5 should be re-ordered and redrafted to bring out the fact that the quicker completion of defence orders had not only led to higher defence expenditure than planned but had also resulted in the Services getting new equipment more rapidly than expected. We should bring out the benefits as well as the disadvantages of the acceleration in the defence programme. On the other hand, the second sentence of paragraph 7 seemed to understate the effect of the changes in the shipbuilding programme on the warship construction programme, and the Defence Secretary agreed that he would revise this sentence to make it clearer.

Mr. Nott said that paragraph 2(b) of the Chancellor of the Exchequer's minute of 19 January about the BAe flotation assumed that any overspend on the 1980/81 cash limit for the defence budget would be offset by a compensating reduction in the 1981/82 cash limit. He did not challenge this as a reflection of general cash limit doctrine, but in the case of the MOD Cabinet had agreed in November that there should be a review of the cash limit in the summer of 1981. The fact was that if the cash overspend in the present year was clawed back in full, the defence programme would be brought to a halt. As he had explained in his minute of 16 January, to find a further saving of £40m. next year would lead to the closure of four shipyards. If he had to go substantially further than this, as he would if he had to claw back the whole of the overspend in 1980/81, the effects on defence industry would be disastrous. None the less, he would do what he could at the time of the cash limit review to offset the cash overspend in the present year.

The Chancellor of the Exchequer said that he understood the Defence Secretary's difficulties. He was ready in the mid-year review of the cash limit to take account of any exceptional movement in defence prices; the effect of Ministers' decisions on the AFPRB's recommendations; and the need, in principle, to offset in 1981/82 the overspend in 1980/81.

Mr. Nott then raised the suggestion set out in his minute of 19 January that the Youth Opportunities Programme should be expanded to allow young men and women to serve in the army. They would receive £23.50 a week and would join the army for between six and twelve months. The defence budget would meet the costs of their food, clothing and equipment, and in order to absorb them within the existing army organisation without creating new facilities for them, their number would have to be limited to something like 3,500. It was not, however, clear whether the Manpower Services Commission would be prepared to find their pay and allowances.

/In discussion

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In discussion there was general agreement on the political attractions of the proposed scheme, but it was argued that it would be unwise to take a decision on such a new departure in a rush and it would therefore not be sensible for Mr. Nott to mention the idea in his statement tomorrow.

The Prime Minister, summing up the discussion, said that the meeting agreed that Mr. Nott should make his statement on defence expenditure in 1981/82 tomorrow. He should amend the text attached to his minute of 16 January on the lines agreed in discussion and it should omit any reference to the proposal that young people participating in the Youth Opportunities Programme might serve in the army. The Defence Secretary should circulate a revised draft to all members of OD and the Attorney General by close of play today. The meeting also agreed that the Secretary of State for Industry should go ahead with the flotation of British Aerospace in February.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (HM Treasury), Ian Ellison (Department of Industry), Jim Nursaw (Law Officers' Department), and David Wright (Cabinet Office).

Yours etc,

Alwi Shinn

B.M. Norbury, Esq.,  
Ministry of Defence.

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