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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

DEFENCE COSTS IN GERMANY

Note by the Secretaries

Attached is a note on defence costs in Germany. This has been prepared by officials of the Treasury, Foreign and Commonwealth Office and Ministry of Defence under Cabinet Office chairmanship. It is being included on the agenda for the meeting of the Defence and Oversea Policy Committee on 10 July.

Signed JOHN HUNT
CLIVE ROSE
R M HASTIE-SMITH

Cabinet Office

5 July 1979

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DEFENCE COSTS IN GERMANY

Note by Officials

Background

1. The current Anglo-German offset agreement, concluded in October 1977, is the last of a long series of agreements stretching back to the end of the occupation regime in 1955. It was reached after protracted negotiation involving Chancellor Schmidt personally. It provides for a total payment of DM475 million over three years (£120 million at a current exchange rate of DM5.95 to the pound) to be spent on barracks and other facilities for British Forces in Germany (BFG). Although the prescribed period for payment ends in March 1980, the agreement enables any unexpended balance to be paid after that date. The agreement also provides that "bilateral offset arrangements shall be terminated after the expiry of the present Agreement". When it was signed, the Germans were informed that the United Kingdom reserved the right to pursue alternative solutions, including a multilateral one. In reply the Germans said that they were not prepared to consider making further payments towards expenditure incurred by the United Kingdom, even in the case of a multilateral solution. The text of statements made by the two sides is at Annex A. This note considers what approach we should now adopt.

The Costs of British Forces in Germany

2. BFG consists of some 61,000 servicemen (excluding 5,000 detached to Northern Ireland at any one time), 2,500 United Kingdom civilians and 52,000 locally engaged civilians, mainly Germans. There are also some 90,000 United Kingdom dependants. The presence of British forces in Germany in fulfilment of our Brussels Treaty obligations makes a crucial contribution to the defence of Western Europe, and hence the United Kingdom, and to maintaining the cohesion of the Alliance. From a political and military point of view, they are in the right place. The total budgetary cost provided for in 1979-80 Estimates, excluding equipment, is £970 million. Of this, £510 million is the extra budgetary cost of maintaining the forces in Germany rather than in the United Kingdom, and the remainder represents costs which would be incurred even if

Footnote

All the figures in paragraph 2 are at the forecast outturn pay and price rates used for the preparation of 1979-80 Estimates, and at the October 1978 exchange rate of DM5.71 to the pound.

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those forces were in the United Kingdom. There is also a foreign exchange cost and the gross cost to the balance of payments (the "stationing cost") is £660 million.

3. The net cost to the balance of payments, after making estimates for the additional imports into the United Kingdom which would arise if the forces were based at home and the additional United Kingdom exports to the Federal Republic of Germany (FRG) which are generated by the presence of British forces there, cannot be quantified with any precision but is a good deal less than £660 million. £450 million seems a reasonable broad estimate (on the same price base as the figure of £660 million). £450 million is 1 per cent of the United Kingdom's total annual imports (£46,000 million) and about 13 per cent of total annual Government invisible debits abroad on current account; it is about the same size as the total current account surplus in 1978.

4. Over the past decade stationing costs have risen faster than defence costs generally; in the current year they stand at about 8 per cent of the defence budget compared with about 5 per cent in 1969-70. In real terms, ie in terms of the volume of exports needed to finance them, stationing costs over the last 20 years as a whole have grown at an average annual rate of between 5 and 6 per cent, but the increase occurred almost entirely between 1968-69 and 1973-74, when real costs doubled. Over the last five years they have been approximately stable. (Detailed figures are at Annex B.) This higher real burden has occurred not because of increases in troop numbers or the volume of support services but because, after allowing for the appreciation of the Deutschmark against sterling, costs in Germany have risen faster than those in the United Kingdom. This has happened because the Deutschmark has appreciated against sterling by more than would be needed just to offset the differences in inflation in the two countries, particularly in the case of services, which form the bulk of our expenditure in Germany.

5. The average annual increase of real stationing costs of some £20 million (at 1975 export prices) over the last 10 years has been small in relation to the average annual increase (also at 1975 prices) of about £1,000 million in all our imports of goods and services. It has however pre-empted resources which we might otherwise have used for force improvements. To provide the necessary additional foreign exchange earnings we have had to accept somewhat

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poorer terms of trade, higher unemployment, and more inflation. Conversely, the German economy has benefited - at any rate temporarily - from improved demand for their services (which can be regarded as exported to BFG) and the higher employment. Moreover, the extra budgetary costs of BFG rose from £102 million in 1974-75 to £310 million in the current year, ie from 2.8 per cent to 5.6 per cent of the defence budget. In this way resources which might otherwise have been used to strengthen our military capability have been pre-empted to meet rising costs in the FRG. The end result - additional costs to us and extra benefits to the FRG - is a case for seeking some form of compensation. But the fact is that formal bilateral offset agreements will end with the present one so any future arrangement would have either to take a different form or to be multilateral. The most appropriate forum for seeking a multilateral arrangement would be within the North Atlantic Treaty Organisation.

The NATO framework

6. The modified Brussels Treaty lays down the level of forces we are committed to maintaining in Europe (see Annex C). Reinterpretations of the level of the commitment (which were sought in each case for financial reasons) were negotiated in 1957, 1958 and 1967 and it would be open to us to seek a reduction in the levels by further reinterpretations should we wish. An account of the previous reinterpretations is at Annex D. The Treaty allows us to invite the North Atlantic Council to review the financial conditions on which United Kingdom formations are maintained if the maintenance of these forces on the mainland of Europe throws too great a strain on the external finances of the United Kingdom. Withdrawals, except with the agreement of our partners, would be a breach of the Treaty. Because the Treaty refers to a strain on external finances, our case for compensation would have to be made on balance of payments grounds, though this would not prevent any scheme to alleviate the problem being based on extra budgetary costs, if it seemed likely that this would be more easily negotiable.

Balance of Payments Aspects

7. Any attempt to convince NATO that we have a case for a review of the financial conditions on which our forces in Germany are maintained would need to demonstrate that this burden is contributing to significant balance of payments problems. The recent trade figures show clearly that our trading performance remains weak. In 1977 and 1978 we had a small surplus on current account, but this was achieved only at very high levels of unemployment and included a

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direct contribution over the two years of nearly £7 billion from North Sea oil and gas. In the first five months of 1979 we had a deficit on current account of over £1 billion. Even though this is probably erratically bad the figures do highlight our poor competitive performance and this will not be easy to improve. Whatever the strength of our case, however, we should expect a critical reception from our allies to claims that we have a balance of payments problem: the advantages of being almost self-sufficient in oil will no doubt be advanced against us.

The attitude of the Germans

8. Whatever scheme we might devise would be designed to ensure that the United Kingdom was a substantial net recipient. An inevitable consequence would be that the FRG would be a net payer and, indeed, the major contributor. The German attitude is, therefore, crucial. We derive political credit from the presence of British forces on German soil, but there is a deep resistance in Germany to historic forms of offset and indeed to any form of payment which might have overtones of occupation costs. Moreover, they believe that our security interests are as much served as their own by the Alliance's policy of forward defence, to which they contribute so substantially; and that the British Government attaches great importance to maintaining the effectiveness of Western defences. They also believe that, whatever the economic benefits, they suffer certain disadvantages from their front-line role, including the environmental and social problems of having large numbers of foreign forces stationed on their soil. They are therefore likely to continue to oppose with great firmness any attempts to persuade them to pay more towards the cost of maintaining BFG, and maintain their reluctance to contribute to any further bilateral or multilateral arrangement. Such is the strength of German feelings, both about offset and about the terminal nature of the deal negotiated with Chancellor Schmidt that any approach to the Germans would have to be made at Head of Government level to stand any chance of being taken seriously.

The position of other allies

9. Any multilateral scheme we sought to negotiate would have to encompass several other European members of the Alliance and, almost certainly, the United States if it were to be seen as a truly Alliance scheme and not simply a disguise for Anglo-German offset. The United States stations some

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230,000 men in the FRG, 20,000 in this country and a further 20,000 in other NATO countries. France stations some 55,000 men in the FRG: Belgium, Holland and Canada station there some 24,000, 9,000 and 5,000 respectively. The FRG has only 3,000 men stationed outside her borders, mainly in Holland. The United States have previously operated bilateral offset schemes with the Germans but signed what was stated to be their final agreement in 1976. Since then they have shown no sign of seeking further agreements despite themselves having significant balance of payments problems. It is also worth noting that the French have no offset agreement with the Germans, despite having considerable forces stationed there, though reasons of geography make it unlikely that the French have a major stationing cost burden. A consequence of any multi-lateral scheme would be that the United Kingdom would have to take account of United States forces stationed in Britain and that the Germans could end up by having to pay something towards the stationing costs of the Belgians and Dutch as well as for ourselves and the Americans: such a scheme could therefore prove much more expensive for the FRG than a purely bilateral UK/FRG arrangement.

Objectives

10. The problem of stationing costs has to be looked at as one part of the wider balance of payments problem. There are other aspects of the wider problem, such as the European Community Budget, on which separate action is being taken. This need not preclude our pursuing some form of compensation for the stationing costs as a case in its own right but any decision to do so would have to take account of the possible effects this might have on other negotiations, such as those on the Community Budget. Ministers will have to decide where the priority lies and may conclude that there is a point beyond which we should not press the case for defence compensation independently of any action being taken in the wider context.

Defence compensation

11. We need first to consider how the initial approaches might best be made and what scheme should be proposed, if we were to seek compensation within the Alliance. A direct approach to the NATO authorities proposing a specific scheme would be unlikely to be successful unless some bilateral preparatory work had been undertaken. This might be necessary with both the Americans and the Germans whose attitudes, for different reasons, might be decisive.

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Since the Germans would be the principal contributors to any scheme, we would need to be clear that they were, in principle, prepared for this and that the sort of scheme we might propose would be one they would find publicly and politically acceptable. We should also need to know that we could expect American support.

12. The US Administration have recently told us, during discussions in a context quite separate from offset, that the foreign exchange costs stemming from their troop deployments overseas have been a significant economic factor in the eyes of Congress and the American people for many years. The Administration take deliberate measures to minimise the foreign exchange burden by giving preference to American sources of supply (even at the price of higher budgetary cost) and by encouraging servicemen to channel their disposable income back to the USA. Pressures to withdraw forces from Europe for balance of payments reasons have been dormant in the United States for some years, and the US Administration has shared the general desire of the Allies not to re-awaken them. They would therefore probably not welcome a British approach to the Germans and might well discourage us from making one. Even if they did support us, the Germans might react unfavourably to a co-ordinated approach by the two Allies who had both earlier renounced bilateral offset. If we do decide to approach the Germans it would therefore on balance be best to inform the Americans concurrently rather than in advance. Before doing so, however, we need to have a workable scheme to propose. We have examined a number of possible schemes, but only two seem worth considering further - Equifund and Host Nation Support.

Equifund

13. The first is a concept which has been under consideration for some years and envisages an equalisation fund to balance out the foreign exchange gains and losses of participating countries on defence account with each other. There are many permutations within the concept which would vary with the number of countries involved and according to how the scheme might be operated in practice. The definition of which costs should be taken into account would need to be settled, particularly whether equipment transactions should be included. To do so might make the scheme less unpalatable to the Germans but it would make negotiations much more complex. The most likely conclusion is to leave them out of account but to keep the point in reserve in case pressures

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built up, for instance in the European Programme Group, for a mechanism to offset foreign equipment purchases and encourage weapon standardisation. An alternative basis for Equifund might be to equalise the extra budgetary costs of stationed troops, but there is insufficient data available to us at present to decide what the advantage of this course would be.

Host Nation Support

14. The second scheme would seek to relieve the nation sending troops of some of their local costs, thus saving budgetary and foreign exchange payments. The relief could be either in the form of the host nation waiving charges normally paid or by the host nation taking over certain functions or services from the stationed forces. The latter option might, however, involve an undesirable loss of control with operational consequences and would need more careful negotiation. The scheme could be operated as a series of bilateral agreements under the aegis of a multilateral scheme which would lay down guidelines on the range of facilities to be covered.

15. Further work would be needed on both these schemes to refine them to the point where we could consider presenting them, even informally, to the Germans. Both schemes are flexible enough to be able to be tailored to produce whatever amount of offset from the Germans we hope to negotiate. It is too early to predict what this might be but, bearing in mind that the current agreement is worth roughly £40 million per year, we might aim at a figure between £50 million and £100 million.

Other schemes

16. If neither of these schemes proved acceptable, we could try to persuade the Germans, despite their earlier objections, to agree some form of bilateral arrangements. These would have to be unpublicised and could probably only take the form of a covert host nation support agreement. It would be extremely difficult to keep - and to convince the Germans that we could keep - such an arrangement confidential. But such an agreement could be of value and, although it seems unlikely at this stage that the Germans would accept it, the possibility might be kept open, perhaps for use at a later stage of negotiation. The Germans might conceivably prefer such an arrangement to attempting to negotiate a multilateral scheme.

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17. A further fall-back position might be to make extended use of the current NATO infrastructure scheme. There are, however, sound arguments for seeking to extract more benefit for the United Kingdom from the scheme as it stands and these are being pursued. But if negotiations on offset were proving unfruitful, it might be possible to use the arguments of our stationing cost burden to secure an improved return from the infrastructure scheme.

The Wider Context

18. The problem of stationing costs has to be looked at in the overall context of the burden of the United Kingdom's overseas commitments which are inhibiting the performance of our economy and imposing an excessive cost on the United Kingdom. The two other principal elements of this burden are our net contribution to the EEC budget and the overseas aid programme (higher than Germany's as a proportion of GNP), on both of which action is already being taken. The pursuit of some form of compensation for the stationing costs of BFG should therefore be seen as part of an overall policy of relieving the burden of our defence commitments. As the situation develops, Ministers may need to decide where our main priorities lie. For the present, however, we can use the fact of our overall burden to support our case, as appropriate, in specific discussion of any one element of it. For example, in discussions on the Community budget with those Community partners who are also members of NATO we can use the defence case as an additional argument, stressing the importance of our contribution to the Alliance and the need to ensure that we can continue to afford to maintain our forces in Germany.

19. Our case for improving our position on the Community Budget must take priority and we should need to ensure that it was not prejudiced by our efforts to secure defence compensation. This might best be achieved by concentrating our efforts on the Community Budget but using the defence case as an additional argument in discussions with those Community partners who are also members of NATO. We should need to convince them of the importance of our contribution to the Alliance and the consequent need to ensure that we could continue to afford to maintain our forces in Germany.

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Conclusions

20. Ministers are invited -

- a. to agree that our case for offsetting the burden of stationing forces in Germany should be treated as part of an overall case that the total and cumulative burden of our overseas commitments is too high and must be reduced overall;
- b. to consider whether our case for compensation should nonetheless be pursued in its own right, despite the difficulties of negotiating a suitable scheme;
- c. if we are to go ahead on offset, to agree that the first approach once we have refined the possible schemes should be an informal one to the Germans which, to have any hope of success, would have to be at Head of Government level, and that concurrently we should keep the United States informed.

Cabinet Office

5 July 1979

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UNITED KINGDOM ORAL STATEMENT MADE BY HM AMBASSADOR AT BONN ON 18 OCTOBER 1977

With reference to the Agreement which we have just signed, I am instructed to inform you that, in concluding this Agreement, the Government of the United Kingdom of Great Britain and Northern Ireland reserve the right to pursue alternative solutions, including a multilateral solution, to the problem of the burden of maintaining British forces on the mainland of Europe and to make a statement to this effect in Parliament.

FRG ORAL STATEMENT MADE BY THE STATE SECRETARY AT THE AUSWAERTIGES AMT ON 18 OCTOBER 1977

The Government of the Federal Republic of Germany repeats the statement which it made during the negotiations on the Agreement that it is not prepared, after the completion of the present Agreement, to consider making any payments or contributions towards expenditures incurred by the Government of the United Kingdom of Great Britain and Northern Ireland in connection with the stationing of British forces in the Federal Republic of Germany. This statement will also apply in the event that the Government of the United Kingdom pursue the idea of a multilateral solution to the problem which in their view arises from the maintenance of British forces on the mainland of Europe.

COSTS OF BRITISH FORCES GERMANY (ie FEDERAL REPUBLIC ONLY)

	STATIONING COSTS £M	AVERAGE EXCHANGE RATE £1 = DM	DEFENCE BUDGET £M		STATIONING COSTS AS A PERCENTAGE OF DEFENCE BUDGET	EXTRA BUDGETARY COSTS £M	VALUE OF ANGLO-GERMAN OFF'S ET	
			at current prices	at constant 1979 Survey Prices			£M at current exchange rates	DM
1958/59	55	12.00	1465	8262	3.8		12	144
1959/60	52	12.00	1514	8314	3.4		24	288
1960/61	58	11.66	1618	8594	3.6		12	140
1961/62	61	11.49	1656	8525	3.7		-	
1962/63	68	11.22	1722	8690	3.9	)	107	600
1963/64	72	11.74	1838	8897	3.9	)		600
1964/65	82	11.10	1999	9376	4.1)		
1965/66	84	11.20	2121	9591	4.0	)	175	1200
1966/67	84	11.13	2172	9261	3.9)		
1967/68	89	10.53	2205	9069	4.0	)	50	550
1968/69	94	9.55	2271	8884	4.1	)	77	710
1969/70	110	9.20	2266	8450	4.9)		
						)	172	1535
1970/71	132	8.72	2280	7583	5.8)		
1971/72	172	8.39	2545	7769	6.8	)		110
1972/73	206	7.72	2854	7948	7.2	)		110
1973/74	283	6.23	3355	8396	8.4	)	220	110
1974/75	340	5.96	3612	7660	9.4	)		110
1975/76	403	5.40	4548	7950	8.9	)	114	110

COST OF BRITISH FORCES GERMANY (1. FEDERAL REPUBLIC ONLY) cont.

	STATIONING COSTS £M	AVERAGE EXCHANGE RATE £1 = DM	DEFENCE BUDGET £M		STATIONING COSTS AS A PERCENTAGE OF DEFENCE BUDGET	EXTRA BUDGETARY COSTS £M	VALUE OF ANGLO-GERMAN OFFSET	
			at current prices	at constant 1979 Survey Prices			£M at current exchange rates	Dflm
1976/77	521	4.29	5632	7981	9.3	137	Nil	Nil
1977/78	569	4.03	6329	7719	9.0	193	(a)	(a)
1978/79	596	3.88	6919	7666	8.6	249	86	318
(i) at autumn 1978 prices	631	3.71	7900	7900	8.0	281	(b)	(b)
(ii) at 1979-80 Estimates prices	661	3.71	8558	7900	7.7	309	(b)	(b)

(a) No payments made in 1977/78

(b) Not yet known. DM 157m remains to be collected.

Extract from the Brussels Treaty

Protocol No II on forces of Western European Union .

Article VI

"Her Majesty the Queen of the United Kingdom of Great Britain and Northern Ireland will continue to maintain on the mainland of Europe, including Germany, the effective strength of the United Kingdom forces which are now assigned to the Supreme Allied Commander Europe, that is to say four divisions and the Second Tactical Air Force, or such forces as the Supreme Allied Commander Europe regards as having equivalent fighting capacity. She undertakes not to withdraw these forces against the wishes of the majority of the High Contracting Parties who should take their decision in the knowledge of the views of the Supreme Allied Commander Europe. This undertaking shall not, however, bind her in the event of an acute overseas emergency. If the maintenance of the United Kingdom forces on the mainland of Europe throws at any time too great a strain on the external finances of the United Kingdom, she will, through her Government in the United Kingdom of Great Britain and Northern Ireland, invite the North Atlantic Council to review the financial conditions on which the United Kingdom formations are maintained".

Account of previous reinterpretations of our commitment

1. The Protocol "modifying" the Brussels Treaty was signed in Paris on 23 October 1954 and ratified on 6 May 1955*(1). The level of United Kingdom Forces on the mainland of Europe was set at 4 Divisions and the Second Tactical Air Force*(2). No other participating country has so specific an obligation.

Reduction of United Kingdom Forces

2. Under the Treaty the requirement is not that a majority of the WEU Council should be in favour of any redeployment but merely that a majority should not be against. It is thus not essential for a vote to be taken in the WEU Council. In order to observe our treaty obligations*(3), when proposing force level reductions the following procedure was adopted:

- a. for the WEU countries to have advance knowledge of any proposals;
- b. for SACEUR to be informed and to express his views;
- and c. for the WEU Council to acquiesce in the United Kingdom decisions.

The WEU Council has "acquiesced" on three occasions, 18 March 1957, 29 January 1958 and 19 December 1967.

* (1) Treaty of Economic, Social and Cultural Collaboration and Collective Self-Defence signed at Brussels on 17 March 1948 as amended by "The Protocol Modifying and Completing the Brussels Treaty". (signed at Paris on 23 October 1954).

* (2) Protocol II Article VI

"..... will continue to maintain on the mainland of Europe, including Germany, the effective strength of the United Kingdom Forces which are now assigned to the SACEUR, that is to say four divisions and the Second Tactical Air Force, or such other forces as the SACEUR regards as having equivalent fighting capacity"

* (5) Protocol II Article VI

"..... She (HM) undertakes not to withdraw these forces against the wishes of the Majority of the High Contracting Parties who should take their decision in the knowledge of the views of SACEUR. This undertaking shall not however bind her in the event of an acute overseas emergency. If the maintenance of United Kingdom forces on the mainland of Europe throws at anytime too great a strain on the external finances of the United Kingdom she will, through HMG, invite the North Atlantic Council to review the financial conditions on which the United Kingdom formations are maintained.

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1957 Reduction

3. In 1956 plans were made for the complete reorganisation of the British armed forces, worldwide, thus permitting the abolition of conscription. These were not publicly announced until April 1957, although the Prime Minister indicated in the House in January 1957 that a review of Defence Policy was underway. Proposals to reduce the size of British Forces in Germany were put to the WEU Council on 14 February 1957 and the reasons put forward were all economic. Lord Hood, our representative, began his statement by saying:

"As the Prime Minister indicated in the House of Commons on 24 January, it is the intention of HMG to reshape their defence policy and to reorganise and reshape the armed forces in such a way as to achieve a substantial reduction in the burden that defence at present imposes on our economy. Our forces in Great Britain, the Far East, the Middle East and on the mainland of Europe will all be affected".

He went on to the detailed economic arguments and our specific proposals which were to reduce the United Kingdom force level from about 77,000 (ie four divisions) to 50,000 plus 5,000 "strategic reserves" stationed in the United Kingdom, and to reduce the Second Tactical Air Force from 466 aircraft to 216.

4. SACEUR recommended that implementation of the reductions should be delayed, that the proposed "strategic reserve" should be stationed on the Continent and not in the United Kingdom, and that certain units of the RAF based in the United Kingdom should be "rotated" on the continent.

5. In the knowledge of these views the Council decided at its meeting on 18 March 1957 to recommend to the North Atlantic Council to review the resources of the Alliance covering amongst other things "a common solution of currency problems arising from the stationing of troops in other Member States". HMG, pending the result of this NATO review, agreed to reduce British forces in Germany by 13,500 men (leaving 63,500) and the WEU Council acquiesced to this.

1958 Reduction

6. On 3 December 1957 HMG announced to the WEU and North Atlantic Council that they were obliged to invoke the final sentence of Article VI of Protocol II (see *3). In accordance with a NATO procedure established earlier in the year, the Secretary General of NATO appointed three independent experts to consider the British case. They confirmed that the United Kingdom was experiencing serious

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balance of payments difficulties and that the cost of stationing forces on the Continent represented a heavy burden on the United Kingdom balance of payments during the financial year 1958/59. The Council in the knowledge of this advice acquiesced on 29 January 1958 to the withdrawal of a further 8,500 troops (leaving 55,000). The only part of the original 1957 proposal not agreed or pursued was the withdrawal of 5,000 men to the United Kingdom to form a "strategic reserve".

1967 Reduction

7. On 19 August 1966 the United Kingdom made a statement to the WEU Council on foreign exchange costs, and warning was given that in view of the difficult economic situation HMG might wish to seek a reduction in our level of forces. The United Kingdom proposal to redeploy one brigade of approx 4,500 men (ie 6 Brigade) and one RAF helicopter squadron was put to the WEU Council on 2 May 1967. These forces were to remain earmarked for assignment to SACEUR and under the command of BAOR and RAFG. After SACEUR had given his views the WEU Council acquiesced to the proposal on 19 December 1967.

5 July 1979

CONFIDENTIAL