

SECRET

3B

PRIME MINISTER

Defence Budget

Sir John Hunt has reported that Mr. Pym has now gone along with Option 5 on the Defence Budget, ie we publish the "Biffen" figures; explain that they are less than 3% by volume but make clear that they contain no provision for the replacement of the deterrent which will be financed by additional provision from the contingency reserve. He has also accepted that the question of manpower cuts in the MOD should be separated from the problem of the Defence Budget and should be dealt with later. I understand that getting Mr. Pym's agreement to go along with this package was more difficult than had been expected.

Sir John Hunt has also told me that Sir Douglas Wass has briefed the Chancellor of the Exchequer against Option 5. He is still of the view that the cost of the replacement of Polaris should be contained within the "Biffen" figures at the expense of provision for conventional forces.

Now that Mr. Pym is on board, however reluctantly, the way is clear for you to see the Chancellor to get him to go along with Option 5. There would be advantage in getting this sewn up quickly (though not reporting the outcome to Cabinet until its meeting on 1 November). May I now arrange a meeting with the Chancellor as soon as possible?

Yes
OK.

JAW.

Prime Minister.

22 October 1979

I mentioned this to you this afternoon and you agreed to see the Chancellor as soon as possible. We have in fact arranged this for 0845 tomorrow Tuesday. The other papers are below.

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JAW

22x.

Prime Minister.

Ref: A0464

HW
19x.

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PRIME MINISTER

Defence Budget

Following my conversation with you on the telephone at Northolt yesterday, I can now report that the position has been held at least for the next few days and that I can see the possibility of a solution.

2. Before coming to that I would like to deal with the question of the Cabinet minutes. I have withheld the minutes on this item today (this is easily done, since it will go as a 'Limited Circulation Annex') and I attach the draft which I have in mind to circulate. As you will see the section on defence neither records a final decision nor specifically leaves the matter open. It talks about a majority view. This may be helpful in considering the tactics which I outline below and avoids pushing Mr. Pym into a corner at this stage. Are you content that the minute should go round in this form?

3. Next I think I should spell out what I understand to be Mr. Pym's attitude. This is based both on a conversation I have had with him myself and on three talks with his Permanent Secretary (Sir Frank Cooper) with whom he has been in close conclave.

Alton

4. Mr. Pym has three main objections to the Treasury line as it was put at Cabinet. First, he believes he is already publicly committed, with your support (Mr. ^{Cooney's} Lankester's letter of 14th May) to the 3 per cent target in the sense in which he interprets it. Second, he objects strongly to what he describes as the 'jiggery pokery' involved in the kind of presentation suggested by the Chief Secretary. Third, he refuses to mislead either the Alliance or the Party (in this connection it is relevant that Dr. Aaron brought a message this week on the crucial importance which the Americans attach to our achieving the 3 per cent if the other allies are to be kept up to the mark). I suspect that underlying his objections of principle there may be another concern: it has always been clear in MISC 7 that there is no replacement for the deterrent in the Defence Budget at present, and the figures suggested by

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the Chief Secretary will leave no room for this. By pure coincidence it so happens that the cost, towards the end of the period, of the replacement deterrent would be roughly the same as the difference between the Chief Secretary's and the Secretary of State for Defence's figures!

This refers to the cost of the PESC period.

5. Mr. Pym is also very concerned about the question of staff cuts, which Cabinet is due to consider on 1st November. The Chiefs of Staff are almost more worried about Lord Soames' likely proposals than they are about the disagreement with the Treasury over the 3 per cent arithmetic. They were on the point of exercising their right to ask to see you last week, but he has successfully held them off for the time being. If Cabinet insisted both on the expenditure cuts and on the staff cuts i.e. a double blow, you might well be faced with a threat of resignation by the Chiefs and the Secretary of State for Defence's position would be even more difficult. Any solution will have to take account of this point. I return to this below.

See Lord Soames' minute of 19 October to you in the red box.

6. Whatever the main reason underlying Mr. Pym's attitude I am clear that, while he will do nothing in a hurry, he will not in his present frame of mind accept yesterday's Cabinet decision. Following a private talk with the Permanent Secretaries concerned, I have prepared a list of the possible options. We all think that the options at the extremes of this list will be unacceptable either to Mr. Pym or to the Treasury. I think Option 5 has some chance of being accepted by Mr. Pym: and Sir Frank Cooper agrees. Whether the Chancellor would accept it is another matter: Treasury officials would like to squeeze our conventional forces to make room for the deterrent but this seems to me quite unrealistic. The essence of this option would be that the White Paper would contain the Chief Secretary's figures but not his rationalisation of them. It would go on to say that while the figures provided for a volume increase in defence spending over the period a little below the NATO target, they contained no provision for replacing the deterrent which would fall to be decided in the period - and provision for which would be made from the contingency reserve [It might also be possible to use the

attached below

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occasion to pave the way for a change in the presentation of our figures on to the cost basis favoured by the Chief Secretary. All of this would require careful, but not impossible, drafting.

7. If a solution on these lines is not possible the only course I can see which will avert the situation we feared is some way of "fuzzing" the later years: but this would be much less satisfactory.

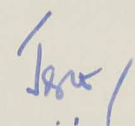
8. This arrangement would not however resolve the manpower issue, which it would be prudent to settle at the same time. Defence might be able to offer a saving of another 15,000 staff, including the 3 per cent cuts they have already imposed. You have however had a minute from Lord Soames today making it clear that he wants to go for a full 10 per cent cut on the Ministry of Defence. Unless both Mr. Pym and the Chiefs of Staff can be overruled on this, Lord Soames will have to be persuaded to drop his bid, perhaps on the argument that the separate in-house studies being undertaken by the Ministry of Defence would produce further savings in due course. But this would leave the Cabinet very well short of the 10 per cent overall target which was tentatively agreed in September, and there may well be problems in other areas (the Revenue Departments and DHSS) as well. I understand that the CSD view is that we shall be lucky to get cuts of 5 - 6 per cent overall.

9. If you think a solution on these lines is appropriate, I believe you should avoid an early meeting with the Secretary of State for Defence; (and I understand that he is not seeking an early one with you). You should first see whether Option 5, or something like it, would be acceptable to the Secretary of State for Defence and to the Chancellor. The Home Secretary might be a suitable intermediary for this purpose. If it can, then Lord Soames will also have to be brought to agree. There is then a separate problem of presenting the agreement to the rest of the Cabinet (on 1st November, I suggest rather than 25th October). Option 5 has the advantage of leaving the present Cabinet decision standing (and can thus be brought within the terms of the draft minutes attached). It will be entirely consistent with the Cabinet

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decision on 13th September, that, in the second Public Expenditure White Paper on later years, 'the tentative nature of the figures for later years should be emphasised'. (CC(79) 15th Conclusions, Minute 5). But I think you would want to explain to the Cabinet why the prevailing view this week has not been accepted. The attitude of the Chiefs of Staff provides one reason. Another might be the hint that Lord Carrington dropped in Cabinet about the attitude of the Party rank and file and backbenchers. You might even consider asking the Chief Whip to take a few soundings which would indicate that Party feeling would be an important factor. If the principal actors had been approached in advance, and the Cabinet were tackled in the way I suggest, you might then be able to reach a fairly quick agreement on the Defence Budget. You would need to consider whether to make it clear to Cabinet, and get it recorded, that this was an exceptional case, justified by the unique importance of the deterrent; it would not be a precedent for any other Minister to demand a pre-emptive claim on the contingency reserve.

10. As you know, I shall be at Chequers on Sunday and you may wish to have a further word then. Meanwhile, I suggest that you should resist any attempt by the Secretary of State for Defence or the Chancellor of the Exchequer to speak to you privately about this over the weekend. Your own position in this is too important to be compromised at the start, and I am sure it is best to operate at one remove, coming in yourself only when there is some prospect of an agreement.


(John Hunt)

19th October 1979

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ANNEX - OPTIONS

- OPTION 1: Publish "Biffen" figures: defend on Treasury lines.
- OPTION 2: Publish "Biffen" figures: admit fall short - though not much short - of our own past hopes but we are all we can afford in the light of our economic prospects/inheritance. Still our fastest growing programme.
- OPTION 3: Publish "Biffen" figures: explain as in Option 2 but add "hope to do better if our economic circumstances permit".
- OPTION 4: Publish "Biffen" figures: say all figures after 1980-81 provisional but we intend to adjust them to achieve 3 per cent volume target as period unfolds (we could pray in aid uncertainty about relative price effect in new economic circumstances - though same argument might apply to other programmes).
- OPTION 5: Publish "Biffen" figures; explain that they are less than 30 per cent by volume but make clear that they make no provision for replacement of deterrent, which would be an extra financed from the Contingency Reserve.
- OPTION 6: Publish "Pym" figures: allow public expenditure to rise accordingly.
- OPTION 7: Publish "Pym" figures: find offsetting savings elsewhere.
- OPTION 8: Publish "Pym" figures: adjust contingency reserve.
- OPTION 9: Publish "Pym" figures: adjust contingency reserve; have clear Cabinet understanding that figures for defence for year after 1980-81 will have to be decided in future PES reviews in light of circumstances - adjustment can be either way (de facto position but a Cabinet minute would ensure no later cries of "foul").

S E C R E T

Defence.

DEFENCE EXPENDITURE

1. The Defence figures in C(79)35:-
 - (a) rise by 3 per cent a year in cost terms from 1981/82 to 1983/84;
 - (b) rise by an average of 3 per cent a year in volume terms over the five years ending 1983/84;
 - (c) add £700m to the previous Government's planned figures for the last three years of the PESC period;
 - (d) raise the defence share of GDP from 4.9 per cent in 197 to over 5.5 per cent in 198 , and of total public expenditure from 11 per cent to 13 per cent.

2. By presenting our defence figures in cost terms, we bring our practice into line with most of our Allies. Our proposals can thus be fairly represented as consistent both with our Manifesto commitment and our undertaking to NATO. To make any change from the position now reached would cast grave doubt on our strategy for public expenditure - and on the firmness of our commitment to that strategy.