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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

DEFENCE SALES

Note by the Secretary of State for Industry

1 The industrial advantages of defence sales are potentially very great: lower unit costs for our own services, increased employment, and the maintenance and expansion of the high technology base on which our survival as an industrial nation will increasingly depend. I therefore welcome the proposals for increasing defence sales set out in the Note by the Secretary of State for Defence (OD(80)70) so far as they go and wholly endorse his view that "defence sales should be seen as a legitimate component of foreign policy ... " and that "we should defend them unapologetically in public". However, while this must be largely for the Defence Secretary's judgement, I am not myself convinced that his proposals are sufficiently radical to attain the objective set out in the Prime Minister's Farnborough Air Show speech.

2 All too often the short-term political difficulties in a particular sale, determine our policy even where delivery will not take place for some time, in some cases perhaps even for some years. Moreover, a defence sale to a particular country can increase our influence in that country over many years, particularly where, as with aircraft, there is a long-term dependence on modifications and on spares. In my view therefore much more weight needs to be given to the long-term aspects in weighing short term political difficulties.

3 In this context we need to consider whether our public relations on defence sales are right. I suspect that we need to publicise the economic benefit of defence sales much more than we do.

4 I cordially endorse the Defence Secretary's statement that "we must give defence sales support in Ministerial visits". It seems clear that quite special opportunities for defence sales are now opening up in the Gulf area. Ought we to be thinking about an orchestrated programme of Ministerial visits there? French Ministers from the President down have been most active in this area.

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5 While the Department of Industry would be happy to join in any discussion about credit, I wonder if other financial aspects should not also be separately studied. I have in mind particularly the Commercial Exploitation Levy (CEL) and the associated levy on Royal Ordnance Factory sales. I appreciate that CEL is not charged where the manufacturer does not make a certain profit level. But British Shipbuilders have complained that the Ministry of Defence do not waive CEL on British weapons and equipment on warships they build; and this thus reduces their competitiveness on the world market. More fundamentally, what is the effect on the Defence Budget and/or the Exchequer of the receipt of these levies? Would it be more cost effective for these levies to be used to stimulate further defence sales and thereby further reduce unit cost to the Services?

6 I welcome the progress that is being made in giving due weight to the sales considerations in forming our equipment requirements while accepting that the Services must get what they need. This Department is playing a part in this at the stage of the Defence Equipment Policy Committee and I intend that, following arrangements recently introduced at official level, it should also make a contribution at the stage of the formulation of operational requirements. The maximum progress, however, will be made only if there is a full commitment among all concerned in choices of equipment to the Prime Minister's objective.

7 On a point of less fundamental importance, there may be scope for making small "demonstration" purchases of defence equipment even where we have no overriding defence requirement ourselves for it, or where we have chosen to standardise on another equipment. Such purchases would entail additional operational and capital costs, but, where these are judged worthwhile on industrial support grounds, we should be prepared to see the services used, in effect, as a contractor to show confidence in UK manufacturers' equipment. Two current possibilities are the Vickers Valiant Tank and the Land Rover - based Laird half-truck.

8 Finally, the French are exploiting their oil deficit by arguing to Middle East customers that, since France needs their oil long-term, there is no danger of France cutting-off their future supply of spares for French arms sold. In contrast, we are the only advanced industrial country in the world moving into an oil surplus but have not so far exploited this in a defence sales context. I understand that officials are considering a suggestion that defence sales to countries with an oil deficit might be promoted by associating with the sale an undertaking to hypothecate a supply of British oil at commercial prices in the event of a future temporary interruption of oil supplies: in a sense British oil would be offered as a kind of "spares provisioning" if necessary. There may be difficulties in the suggestion but I hope that it will be considered constructively.

K J

Department of Industry
1 December 1980