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7 November 1983
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From the Private Secretary

Dear Janet,

Public Expenditure Survey 1983: Defence

The Prime Minister held a meeting on Friday 4 November with the Chancellor of the Exchequer, the Secretary of State for Defence and the Chief Secretary. Also present was Mr. Gregson. The meeting discussed public expenditure on the defence programme following the MISC 99 deliberations and the Lord President's meeting on Friday morning with the Secretary of State for Defence and the Chief Secretary.

The meeting first discussed the provision in 1984/85 and 1985/86. The Secretary of State for Defence said that he had dropped his additional bid to cover the extra cost of the 1983 Pay Review. He was also prepared to drop his bid for inflation compensation provided that a form of words was agreed which would cover the defence programme against the risk that inflation was different from that projected. Finally he had agreed to a reduction below base line. This produced figures of £17,010 million in 1984/85 and £18,040 million in 1985/86 (both including provision for the Falklands). These were the figures agreed with the Lord President earlier in the day. The meeting endorsed these figures.

The meeting then considered the formula which is recorded in the Secretary of State for Defence's letter to you of 4 November. This read

"Alone of its public expenditure programmes, the Government's defence policy is currently expressed in both volume and cash terms. In order to fulfil the Government's commitments up to and including 1985/86, the cash provision will be reconciled year by year in the light of the volume requirement and of the most up-to-date forecasts of inflation and appropriate adjustments made."

The Secretary of State for Defence explained that in his view the formula would permit a review of the allocation to defence to preserve the intended volume if actual inflation diverged from the forecast path in either of the next two years.

/ The Chief Secretary

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The Chief Secretary said that he had not envisaged that the words would embrace an adjustment to cash limits for any year, once they had been set. The Prime Minister said that in her view the natural interpretation of the words "year by year" was that cash limits would not be reopened during the year to which they applied. If the Secretary of State for Defence wished to pursue the matter further, he should do so bilaterally with the Chief Secretary. It was however agreed that the reference in the text to "volume" should be replaced by "real".

The meeting then considered the provision for 1986/87. The Secretary of State for Defence suggested that this could be dealt with in a number of ways. A figure could be entered which uprated the agreed 1985/86 figure by the 3% cash factor applicable to all other programmes. Adjusting for expenditure on the Falklands, this would produce a figure of £18,464 million. This could be accompanied by a statement that

"The Government has not yet determined the provision for defence after 1985/86 which will be considered in the light of international developments and economic circumstances nearer the time."

Alternatively the meeting could agree on a substantive figure. This could lie within a range starting with the zero real increase, going up to a 3% real increase. He recognised however that it would not be realistic to propose an increase at the top of this range. He suggested that there was merit in a figure of £18,710 million which would allow him to substantiate the claim that defence had increased by 21% in real terms (being achieved only a year later than originally envisaged).

In discussion it was argued that the first formulation was unacceptable. The Government ought to be in a position to say what its policy was. Furthermore, defence planners needed to know what basis they would be working on. It was argued that with the use of different deflators the claim of 21% real growth could already be substantiated.

After some discussion it was agreed that the figure for 1986/87 would be £18,650 million. This was on the understanding that it was a cash figure, with no implied volume commitment, and that it would not be qualified in any way.

Summing up, the Prime Minister said there was now agreement on figures for all three years which could be incorporated into the MISC 99 report. If the Secretary of State for Defence wished to pursue further the question of the timing and frequency of the review of the cash limits under the inflation formula he should do so bilaterally with the Chief Secretary.

/ I am copying

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I am copying this letter to John Kerr (H.M. Treasury), John Gieve (Chief Secretary's Office), Richard Mottram (Ministry of Defence), Richard Hatfield (Cabinet Office) and Peter Gregson (Cabinet Office). I am also copying this to the Private Secretaries to the other members of MISC 99.

Yours sincerely

Andrew Turnbull

Andrew Turnbull

Miss Janet Lewis-Jones,
Lord President's Office.

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Mr. Turnbull

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I agree with Mr. Grogan that you have done an excellent job. I have suggested another couple of amendments, aimed at avoiding any dissent from Mr.

P.01152

MR TURNBULL

cc Mr Buckley *Hereline*
Mr Potter

FRS
7.11

PUBLIC EXPENDITURE: DEFENCE

Thank you for letting me see the note of the defence meeting on 4 November, which is excellent. I have only two points.

2. First, I would be inclined to tighten up the passages relating to the ambiguity of the inflation formula on the following lines:

Amend the words at the bottom of page 1 and the top of page 2 as follows:

"The Prime Minister said that in her view the natural interpretation of the words "year by year" was that cash limits would not be reopened during the year to which they applied. If the Secretary of State for Defence wished to pursue the matter further, he should do so bilaterally with the Chief Secretary. It was however agreed *that be reference*

Amend the last sentence in the summing up paragraph to read:

"If the Secretary of State for Defence wished to pursue further the question of the timing and frequency of the review of the cash limits under the inflation formula he should do so bilaterally with the Chief Secretary.

3. These changes are designed:

- to remove the implication that there is a large measure of ambiguity about the formula (I am sure that there is but we do not want to give official endorsement to this idea)

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- to put the Secretary of State for Defence more clearly in the position of demandeur, working against the grain of the actual words
- to make it clearer that any subsequent resolution of this matter is to be bilateral.

4. Secondly it would be courteous to the other members of MISC 99, and help to keep them in the picture, if you could add them to the copy list (ie the Secretaries of State for Scotland and Trade and Industry, the Lord Privy Seal and the Chancellor of the Duchy).

4. On the question of publication I can confirm that this possibility was not raised in relation to the inflation formula either at the MISC 99 meeting or at the Lord President's meeting at 10.00. By contrast, it was always clear that the other form of words relating to the 1986-87 figure was specifically designed for external consumption and was intended to be used in the White Paper.

5. The letter of 4 November from the Secretary of State for Defence to the Lord President, which was written immediately after the Lord President's meeting, did however confirm his agreement to the form of words on the basis that they would be published. I agree with you that the question of publication of this form of words was not raised at the Prime Minister's meeting. It is a matter for your judgement as to whether you say so specifically in your note of the meeting.

PLG

P L GREGSON

7 November 1983

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