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PRIME MINISTER

THE DEFENCE PROGRAMME

I have seen John Nott's minute of 16 June to you. I well understand the problems which he outlined. I am very ready to give them urgent and sympathetic consideration. But I really don't think the approach he suggests is quite right.

2. As he indicates, it would involve our committing ourselves in principle now to substantial additional public expenditure on defence on the basis of information still unreliable and incomplete about costs incurred and replacements needed; before the lessons of the Falklands operation for our defence strategy have been properly appraised; and at a time when other bids from both the defence and civil programmes for large additional expenditure in the next two or three years are giving cause for considerable concern.

3. Our economic strategy depends on a tight grip on public expenditure. Without that, we shall fuel inflation and risk tax increases. The lesson of current events in France is highly pertinent.

4. John's proposals would require at least an extra £700 million over the next three years in addition to £500 million in the current year, and on top of the additional bids he has already made in the public expenditure Survey for £3,200 million in cash over the same period to provide for 3 per cent real growth in defence expenditure. There are further costs to come, as yet unquantified, for the future protection of the Falklands (the garrison alone is said to require £300 million capital expenditure and £150 million

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a year running costs) and the adjustments to defence policy which might emerge from the studies set in hand.

5. This huge additional bill - more than £1 billion a year on average - would mean a major deflection from the economic policies we are currently and rightly pursuing.

6. Nor am I convinced that all this additional expenditure is necessary. We need a thorough and detailed examination before additional commitments can be undertaken. And I think we need to pay particular attention to the following points:-

- (a) The NATO 3 per cent growth target already strains our resources. It must be seen in proper perspective. It applies to the total defence expenditure of member countries: everything counts, whether or not it is directly related to meeting the Soviet threat. Other countries, notably the US, legitimately count expenditure on non-NATO areas as part of their Defence Budget, and against the 3 per cent target. There is no need for us to disregard expenditure on the Falklands for the purposes of the target.
- (b) There must be a strong case for containing within the annual 3 per cent increment which we plan to achieve as much as we can of the expenditure on new equipment of enhanced capability. All of it benefits NATO.
- (c) The need to replace equipment lost in battle is regrettable, but the cost of replacing it is in principle no different from that of the cost of replacing equipment lost accidentally, for which no bonus would be claimed or given.
- (d) The scale of the Falklands losses may merit special treatment. But the replacement programme must



surely be considered against future need rather than past capability. For example, there is clearly a question about the vulnerability of surface ships. It was voiced in Cmnd 8288. The recent operation has confirmed those doubts. Can it really be right to replace the four sunk warships with four frigates of a design which it had previously been decided should be replaced by a new anti-submarine design framed with an eye to the export market?

7. The replacement package calls for careful and detailed study before we commit ourselves, even in principle, to any significant part of it. The decisions should not be taken piecemeal, but as part of a plan aimed at the threats of the future, not the battles of the past. This applies to the proposed retention of HMS Invincible. The maritime strategy outlined in Cmnd 8288 required only two ships of this class. If all three are now to be retained, and nothing given up, that amounts to a major increase in the maritime content of the defence programme. The costs of retaining HMS Invincible, if that is indeed now thought right, can hardly be treated as part of the costs of the Falklands operation.

8. In short, there are two separate issues here.

9. First, we have to assess what changes are needed in the defence programme in the light of the Falklands operation. The replacement package needs to be properly assessed and substantiated, the lessons of the Falklands thoroughly appraised, consequential adjustments to the defence programme identified.

10. Second, when this has been done, we need to assess the costs of the changes needed, and to decide to what extent they can be funded within existing planned provisions for the defence budget, and what if any additions are inescapable. These additions should be reviewed in an orderly and efficient way in the context of the public expenditure Survey, and considered against other proposals



for public expenditure so that we can take a sensible and considered decision about relative priorities and about the things we have to set aside or postpone. To rush into premature and piecemeal decisions, involving such substantial sums of money, before they have been adequately appraised and quantified, and the need firmly established and weighed would be bad economics, bad management and in my view bad politics too.

11. There is one other matter on which urgent consideration is needed. Substantial additional costs have arisen from the Falklands operation in the current year. These need to be fully quantified so that whatever adjustment may be needed to the defence cash limit for the year can be properly determined. Not least because some hundreds of millions of this year's defence spending was brought forward into 1981/82, to avoid a corresponding underspend on that year's (increased) cash limit, there is some headroom within the existing defence cash limit. This ought to be taken up first. The existing cash limit already provides for real growth well in excess of the 3 per cent NATO target. It should be possible for any increase to be substantially less than the Falklands costs arising this year.

12. I am of course fully conscious of the problem which John may face in the forthcoming Debates. But it would be wrong to jump, for reasons of short-term tactical advantage, to decisions which might subsequently seem strategically short-sighted, in military, economic, and political terms. And I believe that the Party well understands the need for a careful appraisal of the lessons of the Falklands, and for the Debates to be used to sound opinion rather than announce instant reactions.

13. I look forward to seeing the additional preface to the Defence White Paper which John proposes to publish next week. I should also like to see, in draft, the proposed statement of his general approach, which will, I hope, reflect the considerations outlined in this minute.

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14. I am sending copies of this minute to the other recipients of his.

*Jolley.*

[ Approved by the Chancellor  
and signed in his absence. ]

G.H.

17 June 1982

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