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cc:PPS



FST
EST
MST
Sir P Middleton
Mr Bailey
Mr Monck
Mr Scholar
Mr P Gray

Treasury Chambers, Parliament Street, SW1P 3AG

Mr Lovell
Ms Conn
Mr Ridley
Mr Lord

Rt Hon Norman Tebbit MP
Secretary of State
Department of Trade and Industry
1 Victoria Street
London SW1

27 September 1984

Norman Tebbit

PES 1984 - DEPARTMENT OF TRADE AND INDUSTRY

At the conclusion of our short discussion on 25 September on your PES programmes I said I would let you have a letter setting out my understanding of our respective positions. This should help to focus any further discussions on the ... main issues. The figures are set out in Annex A attached to this letter.

2 I accept, of course, that we need to take account of both regional and other industrial expenditure. As a matter of procedure, however, we have to discuss regional policy throughout Great Britain at E(A) next week while we have to settle on the rest of your budget through the normal Survey process.

3 I very much welcome the direction of your proposals on regional policy and your agreement to a moratorium on RDGs in 1985-86. Even so the framework you are proposing produces smaller savings in the later years than Nigel and I will propose to E(A).

4 However, even if we achieved all we are asking in the regional policy field, we would still need to secure substantial savings on the rest of your budget in order to hold to the expenditure totals agreed by Cabinet.

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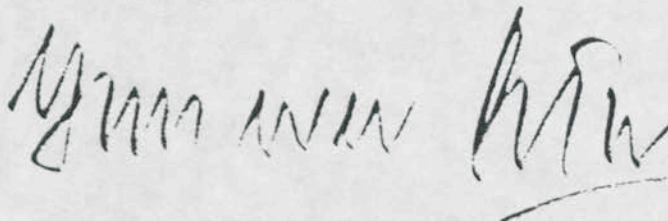
5 In the light of your comments on the practicability of my earlier proposals I have reconsidered what would be possible. I had hoped to explore this with you at our meeting on the basis of the latest figures for "committed" expenditure which your officials gave to mine on Monday. I quite understand why you decided that it was not worth crawling over the figures. I am attaching them to this ...letter (Annex B) so that you can see the basis on which I am making my specific proposals.

6 I accept that the scale of reductions I first proposed for 1985-86 cannot be regarded as practicable. I still think however that there is some room for cutting back here and there. Clearly you will be the best judge of where this is feasible, but I understand that the character of "commitment" in respect of expenditure for aircraft and aero-engine general R & D is much less contractually based than some of the other expenditure. I would have thought that the spend on this item offers considerable scope for reduction. It may be too that there is some scope for increasing revenue in 1985-86 by increasing the charges for the services provided in the promotion of exports and tourism. With these factors in mind, and taking account of the savings you have already offered for 1985-86, I am prepared to reduce substantially my bid for that year from a reduction of £139 million to a reduction of £20 million. I accept that even this much reduced proposal will be difficult for you, but I believe that it is practicable and realistic and it would be a welcome contribution to easing our general financial problems next year.

7 In the next two years the level of commitments falls quite substantially: in 1986-87 uncommitted spending on the selected items totals £243 million, and in 1987-88 it rises to £370 million. I am proposing therefore, much more substantial savings in these years. They would imply cutting back on grant giving programmes, but I suggest they should also include introducing or raising charges.

8 I accept, of course, that savings of this order imply a significant shift in policy. But a shift away from discretionary subsidies and towards reducing distortions in the market seems very much in line with our determination to improve the use of our resources and wider economic strategy. Similarly it seems entirely consistent with our wider approach that we should charge companies for the services Government provides. This allows competition with the private sector and gives an indication of the value of the service.

9 Naturally I would be happy to discuss these proposals with you should you think it worthwhile.



PETER REES

ANNEX A

<u>DTI position</u>	£m		
	1985-86	1986-87	1987-88
Reduced requirements	-14	-25	-37
Further savings made in bilateral	-27	-29	-15
Bids conceded by CST	143	139	49
Bids not conceded by CST	<u>13</u>	<u>25</u>	<u>24</u>
Net change from baseline excluding regional expenditure changes	<u>115</u>	<u>110</u>	<u>21</u>
 <u>CST position</u>			
Reductions in programmes or increased charges	-20	-122	-225
Bids not conceded	<u>-13</u>	<u>-25</u>	<u>-24</u>
	<u>-33</u>	<u>-147</u>	<u>-249</u>
CST net change from baseline excluding regional expenditure changes	<u>82</u>	<u>-37</u>	<u>-228</u>

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GRANT GIVING SUB-PROGRAMMES WHERE REDUCTIONS ARE BEING SOUGHT: BASELINE AND COMMITMENTS

	£ million			
	1985-86 in June 1984	1985-86 in Sept 1984	1986-87	1987-88
1. Selective Assistance to Individual Industries				
- Baseline	94.7	94.7	80.9	82.9
- Commitments	81.7	91.8	59.9	43.9
- Committed: (%) of Baseline	(86)	(97)	(74)	(53)
2. General Industrial R & D				
- Baseline	295.3	295.3	304.4	312.0
- Commitments	225.3	279.2	136.0	45.0
- Committed: (%) of Baseline	(76)	(95)	(45)	(15)
3. Aircraft & Aeroengine General R & D				
- Baseline	35.4	35.4	36.3	37.2
- Commitments	3.4	35.7	3.3	4.2
- Committed: (%) of Baseline	(10)	(100)	(9)	(11)
4. Space				
- Baseline	67.7	67.7	69.0	70.7
- Commitments	68.5	67.1	49.0	40.6
- Committed: (%) of Baseline	(101)	(99)	(71)	(57)
5. Future Industrial Support				
- Baseline	2.7	2.7	1.0	1.0
- Commitments	0	0	0	0
- Committed: (%) of Baseline	-	-	-	-
6. Total - Baseline	488.8	495.8	491.6	503.8
- Commitments	378.9	473.8	248.2	133.7
- Uncommitted	109.9	22.0	243.4	370.1
- Committed (%) of Baseline	(77)	(96)	(50)	(27)

1984 PUBLIC EXPENDITURE SURVEY: DEFENCE

Note of a meeting held in HM Treasury at 9.00am on Friday 28 September 1984

Those present:	<u>HMT</u>	<u>MOD</u>
	Chief Secretary	Secretary of State for Defence
	Mr P J Kitcatt	Sir Clive Whitmore
	Mr M Scholar	Mr N Bevan
	Mr I P Wilson	
	Mr F Martin	
	Mr R Broadbent	
	Mr A N Ridley	

The Chief Secretary suggested that the agenda should be that proposed in his letter of 2 August, using the table attached to that letter.

Efficiency Savings

2. The Chief Secretary invited the Secretary of State's views on the efficiency savings suggested in his 2 August letter. The Secretary of State replied that the savings requested for 1987-88 were not credible either in terms of domestic politics or vis-a-vis NATO, particularly against the background of US Government and Congressional pressure, exemplified in the Nunn/Cohen amendment. In combination with the rejection of his additional bids for inflation adjustment in 1987-88 and for 2% growth in that year, the proposed efficiency reductions would mean a reduction in provision for the defence programme of the order of 4 per cent. He was willing to defend, against House of Commons Defence Committee and other criticism, the present standstill in provision for 1986-77. But he could not defend a substantial reduction in programme provision in the subsequent year. The issue was thus essentially one of principle.

Falklands Provision for 1987-88

3. The Chief Secretary asked whether it would be possible to reduce the bid of £300 million for Falklands provision in 1987-88. The Secretary of State reminded the Chief Secretary of the existing agreement that Falklands costs would be met as an addition to the defence programme and emphasised that the figure was realistic and designed only to meet expected Falklands expenditure. He was, however, happy for Treasury and MOD officials to examine the figure further to

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see if there was any scope for savings at the margin, and he would also be willing to review the figure subsequently should revised planning assumptions about the level of Falklands forces be agreed. On that basis the Chief Secretary indicated that he was willing to accept the bid.

Inflation Adjustment for 1985-86

4. The Chief Secretary also indicated that he was willing to accept in principle the bid for inflation adjustment in 1985-86, subject to the examination by officials of the appropriate figure in the light of the latest inflation forecast. The Secretary of State welcomed this agreement. It was pointed out that, if Cabinet agreed the Chief Secretary's proposal for a 3% pay assumption for 1985-86, this would reduce the baseline for the calculation of the bid. It was agreed that the bid should be calculated after taking account of clawback for the pay assumption.

Additional VAT Payments

5. The Chief Secretary recognised that there was an element of rough justice in asking departments to absorb the increased cost of the Budget change in VAT on building alterations. With the exception of one small concession for church-maintained schools, other departments were absorbing this additional cost and the Chief Secretary hoped that MOD would be willing to do likewise. The Secretary of State said that in these circumstances he would be willing to absorb the additional costs. He further explained that one component of the additional bid related to research and development work now contracted out to the Royal Ordnance Factories. He hoped that it would be possible for this to be refunded under the mechanism provided by Section 11 of the Finance Act 1984, and the Chief Secretary agreed that the Treasury would examine this possibility.

Extra Cost of Review Body Awards

6. The Secretary of State explained that he attached importance to this bid. The sum represented nearly 1% of the defence budget, and additional cash had been made available in past years to meet the real terms growth commitment. The Chief Secretary pointed out that no such adjustment had been made in the 1983 Survey, and that, given his acceptance of the bid for inflation compensation in 1985-86, additional cash for the pay awards was not necessary to meet the 3%

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3% real growth objective. To accept both bids would in effect mean double-counting. Moreover, there was no Manifesto or other public commitment to provide extra cash to meet the costs of such awards, which were no different from any other price change. Since the defence provision after 1985-86 had been agreed in the 1983 Survey on a strictly cash basis, the presumption must be that all price changes would be absorbed. However, the Secretary of State suggested that the terms of the 1983 Survey agreement were that the cash provision for defence would be increased sufficient to meet the "real requirement": increased cash to offset the cost of the pay awards was necessary to maintain the real value of the defence budget. The Chief Secretary pointed out that this argument could not be applied to the years after 1985-86. Moreover, the question of efficiency savings was also relevant in this context: these would enable the "real requirement" to be met without additional cash inputs. He hoped therefore that the Secretary of State would be willing to drop this additional bid.

Inflation Compensation and Real Growth in 1987-88

7. The Secretary of State said that he might be prepared to drop for the present the bid for additional cash in 1987-88 with respect to inflation compensation, provided there was an agreement, similar to that in the 1983 Survey, which would enable future adjustment of the baseline in the light of any changes in inflation assumptions. The Chief Secretary asked what would be the position on the bid for 2% growth in 1987-88 in those circumstances. The Secretary of State acknowledged that there was no commitment to real growth after 1985-86, although there would, he suggested, be very great pressure to achieve some growth. He would not insist on pressing the bid this year, provided that the cash provision for 1987-88 was arrived at on a realistic basis. That in turn would require that the request for efficiency reductions in the baseline should be dropped. It was the Secretary of State's aim to achieve efficiency savings: he needed them to defend the standstill in cash provision for 1986-87 and to accommodate the effects, for example, of sterling depreciation on such things as Trident costs. But he could not motivate his department to achieve such savings if the cash was simply lost to the Treasury. The Chief Secretary pointed out that the efficiency reductions he was asking for built up at a rate of only 1% a year; the department had

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had the benefit of previous efficiency improvements and, in the light of the overall objectives for public expenditure agreed by Cabinet, it was not unreasonable to ask that these benefits should now be shared.

Manpower

8. The Chief Secretary asked whether, in the light of the position outlined in the Secretary of State's letter of 25 June, he was able to offer a firm figure for reductions by 1 April 1988. The Secretary of State emphasised his support for civil service manpower reductions: indeed his concern was that across the board the Government was not doing enough. He was planning substantial reductions below his present manpower baseline: over recent months savings had been identified which would enable the Department to reduce its total to 174,700 by 1 April 1985, and he would have no difficulty at all in achieving a figure well below 170,000 by 1 April 1988. Indeed, he was hoping to achieve reductions of over 4% a year. However, he was unwilling to offer firm figures at this stage. He feared that if he did so, it would simply remove the pressure on other departments to find their proper share of the overall target. The Chief Secretary emphasised that he would not allow that outcome: at the same time it was very difficult for him to press other colleagues for savings if he could not show that the Ministry of Defence was making its contribution.

9. The Secretary of State indicated that he might be willing to provide firm figures for manpower reductions provided there could be some accommodation on his additional bids with respect to inflation compensation in 1987-88 and the extra cost of Review Body awards. The Chief Secretary noted the proposition, but feared that the expenditure totals implied could not be reconciled with the overall objectives agreed by Cabinet on 5 July. He would like to reach an accommodation and would write to the Secretary of State setting out the areas of disagreement and those of potential agreement. The Secretary of State welcomed this, and hoped that it might be possible for the Chief Secretary to propose a quantified package.

cc. Those Present

PPS

Mr Bailey

Mr Gray

Mr Lord

ESTIMATES 1984' = CMND 9227

lead to an annual saving of £2 million in 1983/84 and subsequent years.

CIVILIAN MANPOWER

230. Reduction in the number of civilians employed by the MOD has been a continual process since the unified Department was created in 1964, as the graph at Figure 5 shows. The number of UK-based civilians in the Department has been reduced by 47,700 to 200,000 between 1979 and 1 April 1984, a reduction of nearly 20%. The Ministry of Defence, which comprises one-third of the Civil Service, has contributed nearly one-half of the total Civil Service reductions over this period. Numbers of locally-engaged civilians serving overseas have fallen by 4,700, a reduction of over 12%. The majority of reductions have been achieved without recourse to redundancies, by improving efficiency, general streamlining, privatisation (including contracting-out) and dropping or curtailing functions.

231. Some examples of savings measures already achieved or in hand are as follows:

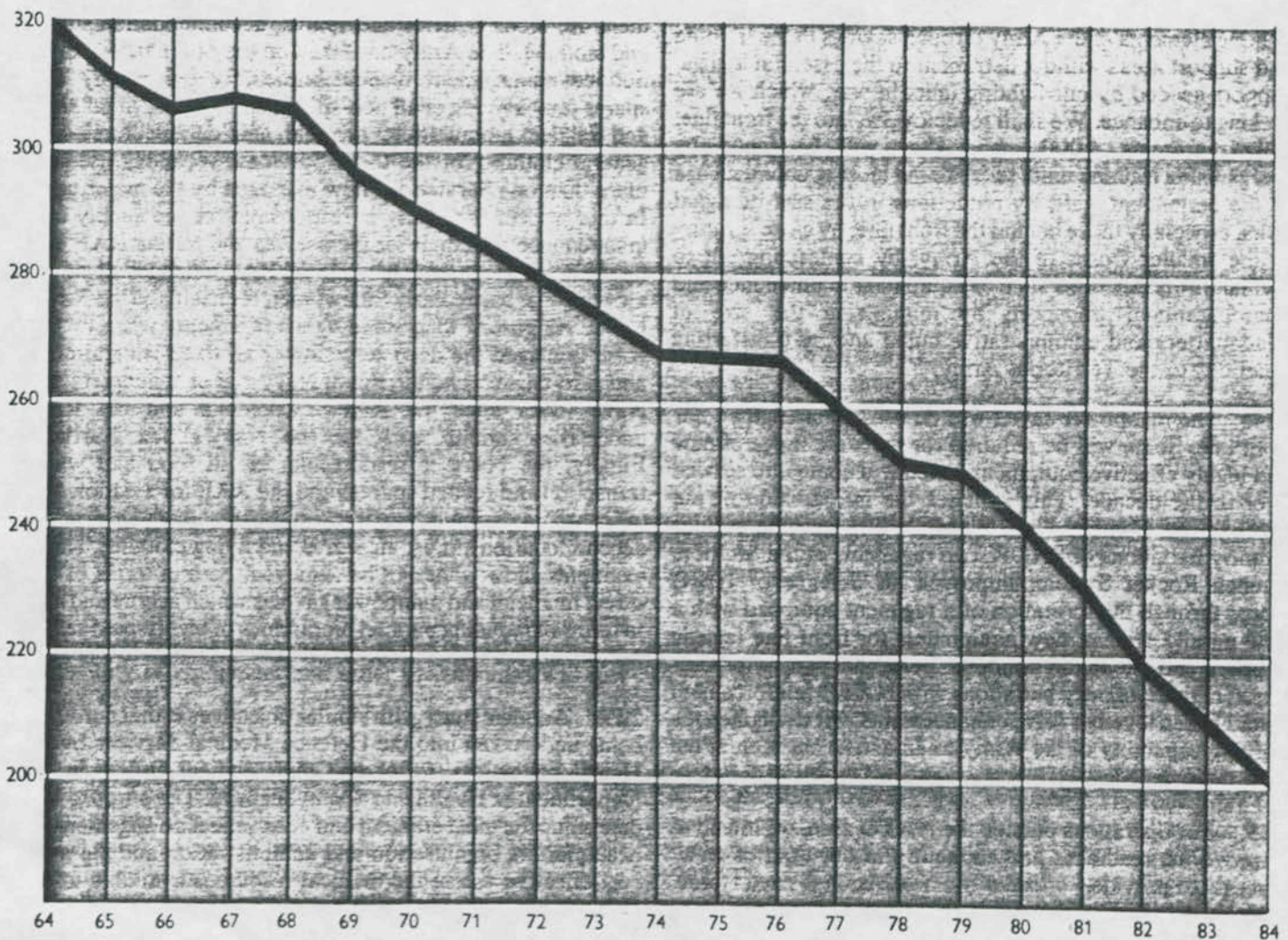
- contracting-out of cleaning and catering at Ministry of Defence establishments is now producing an annual saving of £12 million.
- the introduction of a comprehensive Royal Navy stores inventory system in 1983 should

- the use of improved computer technology in Service pay systems should lead to staff savings amounting to £11 million a year.

232. A whole range of studies and re-organisation now in hand will ensure that the momentum is maintained. For example, a restructuring of the Quality Assurance area of the Procurement Executive, taken together with the increasing development of quality control by defence contractors themselves, will enable the number of personnel employed on these tasks to be reduced substantially.

233. The Department's forward plans, taking account of the privatisation of the Royal Ordnance Factories which will transfer some 18,500 posts outside the Civil Service, assume a total civilian manpower provision of not more than 179,000 by the end of the 1984/85 financial year and not more than 170,000 by 1 April 1988, in line with the Government's target for the Civil Service as a whole. The aim will be to achieve a rate of rundown which significantly betters this target.

Figure 5 The Reduction in Ministry of Defence Civilian Manpower 1964-84

**Note:**

All years have been broadly adjusted to reflect changes in Government Departmental organisation which have affected the Ministry of Defence.