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Rt Hon Michael Heseltine MP  
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*Stan Michael*

STATEMENT ON THE DEFENCE ESTIMATES 1984

*Attached*

In your memorandum OD(84)10 you invited comments on the draft text of this year's statement on the Defence Estimates.

If I may say so, I thought the draft a very positive document. We have an admirable story to tell on defence, and it received full justice. My only detailed comments concern chapter 2, parts of which could be open to interpretations which we should strive to avoid.

At the end of para 203 there is a suggestion that provision for 1986-87 should allow for some further real growth. As you know, the 1986-87 PES figure was settled in cash; what the provision will allow in "real" terms will depend on progress in reducing inflation. My preference therefore would be to avoid reference to possible expenditure input growth, and to concentrate on defence output instead: "Provision for 1986-87 should enable the improvements in capability and the increased investment on equipment to be maintained."

At the start of para 207 there is a suggestion that an autonomous increase in technical sophistication leads to "real" cost increases for defence equipment. But the very interesting paper which your private secretary circulated on 22 September last year demonstrated clearly that technological improvement enables us progressively to reduce the real cost of equipment with any given level of performance. We have been driven to increase the sophistication and cost of equipment only because of the perceived increase in Warsaw Pact commitment and capability. This linkage should be made clear in the SDE; otherwise it may give the impression that MOD are seeking sophistication and gold plating for their own sakes.

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My last point concerns paragraph 236, which detracts from your otherwise very positive commitment to competition.

The reference to defence industrial base questions could cause us difficulties. Last year's report by officials on essential defence technology - commissioned during the Cabinet's HARM/ALARM discussions and eventually circulated by your private secretary on 14 February - demonstrated that it is militarily essential to maintain an indigenous capability in only five areas of defence technology. I hope that we shall have an early opportunity for full discussion of the report and of your minute of 6 January to the Prime Minister; the latter indicates some misunderstanding of Treasury views. But until we have considered collectively the officials' paper, the references to defence industrial base issues cannot be said to reflect our policy; a request to identify publicly the "vital areas" that paragraph 236 refers to could prove awkward. Meanwhile, it could be counter-productive to imply, as the draft does, that in some fields the limited number of domestic contractors restricts competitive possibilities. The less emphasis on potential obstacles to competition, the easier it will be to improve the 20% ratio for contracts awarded after competitive tendering and widen the scope for achieving the impressive savings mentioned in paragraph 238.

It seems to me that paragraph 236 raises more questions than it answers and I think it would be better deleted.

I am copying this minute to the Prime Minister, to members of OD, and to Sir Robert Armstrong.

*Peter Rees*

PETER REES