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CABINET

PUBLIC EXPENDITURE: POST-DEVALUATION MEASURESDEFENCE CUTSMemorandum by the Secretary of State for Foreign Affairs
and the Secretary of State for Commonwealth AffairsGeneral

Given the present situation, we accept that the Government's defence expenditure has to be cut, in line with home civil expenditure, if the new economy measures as a whole are to be regarded as fair and sufficient.

2. We accept also that the stage has been reached where there can be no further cuts in defence expenditure unless the overseas commitments on which much of it is based are themselves reduced. We agree with the Secretary of State for Defence that to attempt to cut defence expenditure any further without reducing our overseas commitments would be to endanger the morale of the armed forces.

3. But after four Defence Reviews, the last of them announced only six months ago, the price is heavy. The cuts we make will inevitably damage our interests. We must remember that there is an important and inherent distinction between domestic cuts and overseas cuts. Civil cuts can be restored once our economic situation is easier; but our position and influence overseas, once lost, will be irretrievable. We need to weigh the political and economic risks with the greatest care.

4. We are involved overseas in many ways and have bonds with many countries. These bonds include our moral obligation to respond to Australia and New Zealand should they be in danger, as they did to us in two world wars; our obligations to a number of other countries and our international legal responsibility, which we cannot divest ourselves of unilaterally, for our dependent territories. What is now suggested is not just a reassessment and reinterpretation of those obligations; it is a question of breaking our obligations and our pledged word. Unilateral action could cause us in the long run economic as well as political harm, on a scale that would greatly outweigh any economies we should make, by damaging that confidence in us and our intentions which we must sustain. As a trading nation we cannot afford to have our word and our intentions doubted. If we are given adequate time for consultation, we may be able to achieve the necessary changes we seek and set some limit to the damage. But we must remind our colleagues that British economic interests are closely involved in the

areas from which withdrawals are proposed. These interests can suffer in two ways. First, precipitate withdrawal can occasion instability leading to revolution or political realignment in which British investments are lost and trading opportunities seriously diminished. Second, we must beware lest the world is led to conclude that if we are forced to such measures as the breaking of agreements reached only six months ago and reaffirmed in Parliament as recently as November, our position since devaluation must indeed have become desperate. There is a real danger they will feel that in fact this time Britain must beyond all question and at last be finished. If that belief ever became general the consequences politically, economically, and for the position of sterling, would be exceedingly grave. The consequences of the action now proposed could therefore prove to have a cost to our balance of payments far outweighing the savings which these measures could produce.

5. We and our officials have taken a long hard look at all our commitments, worldwide. This is what we have found.

Europe

6. NATO is the core of our security, and any unilateral breach of our undertakings could have the gravest consequences, both for our political aims in Europe and for our national security. To make reductions without agreement with our allies would risk a general reaction and the unravelling of the Alliance. Had we attempted to behave in this way we would not have retained the goodwill as we did so successfully in our recent negotiations over the re-deployment of a brigade from BAOR. But the Alliance will not stand still. Changes will come. For example, under the new force planning procedure NATO is re-assessing, and will continue on a year to year basis to re-assess, the force levels it requires. Quite apart from this it might prove possible to make progress towards mutual East-West reductions. Equally if our Allies refuse to maintain their fair share we would have to review our position. Any or all of these could provide an atmosphere for negotiating further reductions, but what we cannot do is to make unilateral reductions on our own. Meanwhile, we should seek, in conjunction with the United States, to settle the offset question and the numbers of our forces on the Continent with the Germans and other members of the Alliance on a proper long-term basis. All this will take time. We accept that, if we are to keep Europe as our main centre of effort, the principal cuts must come from other areas.

Malaysia and Singapore

7. Our Far East Defence policy has been under continuous review and adjustment over the last two or three years. A drastic reappraisal of defence expenditure was made earlier this year and major reductions announced as recently as last July. There was great difficulty in securing the acquiescence of our Commonwealth partners and allies in these reductions. Our Commonwealth partners and the United States were strongly opposed to our declaring a date for our final withdrawal and they all pressed for a continued British presence as a guarantee of stability in an area where historically we had a unique contribution to make. We were only able to secure their agreement to our proposed reductions by not giving a precise date for our withdrawal but stating that it would be in the "middle 1970s"; by reaffirming our intentions to honour our obligations; and by promising a continued military capability for use in the area if required. We also said we were determined that our reductions would take place in an orderly manner and offered significant aid to assist Malaysia and Singapore in effecting the necessary economic transition as smoothly as possible.

8. We recognise that if we are to achieve significant defence savings we must secure an acceleration of the pattern of the rundown in Malaysia and Singapore which has so far been agreed. But given the undertakings which we reaffirmed only last July it is clear that this can only be achieved at a political price and at the risk of economic retaliation. The extent of this damage will depend crucially on -

- (a) The date of completion of the rundown.
- (b) A reassurance of our intention to maintain a continuing general capability which could be used in the area if required.
- (c) Adequate consultation with our Commonwealth partners and allies before a public announcement.

9. We are firmly of the view that the earliest date for the completion of the rundown that would be tolerable would be 31st March, 1972. In Singapore we shall be throwing on to the labour market something like 60,000 people now directly deriving their employment from the British forces, and if for example the rundown were to be completed by 31st March, 1970, this would lead to an unemployment rate of 26 per cent. In Malaysia about 19,000 persons would be put out of work. In Singapore, this could provoke widespread labour unrest possibly leading to the overthrow of Mr. Lee Kuan Yew and the assumption of power by a Communist regime. In that event, so far from our being able to achieve an orderly withdrawal, we might have to fight our way out. In Malaysia the announcement of our early withdrawal would give great encouragement to Communist subversion in a country with built-in communal problems. Moreover if instability developed in Singapore, Malaysia might be tempted to intervene with possible further international repercussions.

10. While we accept that there would be no special capability for use in the Far East after our withdrawal it will be important that the general capability we retain in Europe should be usable overseas when required. We must be able to assure our Commonwealth partners and allies that in this way we shall retain a capability to help them if circumstances in our own judgment demanded it. This would not be anything special to the Far East but simply an expression of the fact that our strategic reserve would be available to be used anywhere in the world where we thought it in our interests to do so.

11. If the above were agreed we should be quite frank and make clear to the Commonwealth countries in the area and to the Americans the limitations which our general capability would place on the nature of any military assistance which we could provide. In effect we should be telling Singapore and Malaysia that how we help them will have to be determined by the circumstances at the time, including the size and shape of the armed forces which we then had. The Anglo-Malaysian Defence Agreement has great psychological value in maintaining confidence in the area. There is in fact no provision for its termination and for us to abrogate it unilaterally would create a profound shock. We should negotiate with the Malaysian Government, so as to make it fit the new conditions.

12. We are glad to know that the Chancellor recognises that the Bill for mitigatory aid to Malaysia and Singapore is likely to be higher. Preliminary calculations indicate that - depending on the date by which the rundown is completed - the aid requirements of Singapore and Malaysia for the three years up to 31st March, 1971 would have to be revised upwards as follows:-

	<u>Singapore</u>	<u>Malaysia</u>
	£m.	£m.
A. Rundown completed by 31st March, 1971	70	28
B. Rundown completed by 31st March, 1972	43	25

Substantial aid will also be required after 31st March, 1971, of the order of £40-£50 million per annum for Singapore and Malaysia together, for a period of several years. We must be able to tell the Malaysian and Singapore Governments, when we disclose our revised timetable, that we shall be willing to discuss the aid implications with them. Ministers should accept now that aid commitments of the order of magnitude mentioned above will be required. A request for negotiating instructions will be submitted later this month.

Hong Kong

13. Hong Kong will become increasingly isolated and the size of our garrison there (7. 2/3rds major units), even allowing for the Hong Kong financial contribution, will become more and more out of scale with the overall pattern of our forces. We are engaged on a study of our policy towards Hong Kong in the longer term but, at the present stage of our relations with China, any immediate reduction in the garrison would cause loss of economic and political confidence in Hong Kong, with its attendant risks. The Communists appear to have recognised that they cannot attain their ends by violence; but they would probably be encouraged to try again, making it necessary for us to reinforce the garrison once more. Even more, the announcement now of a date for total withdrawal would result in a rapid total collapse of confidence, leading to political, administrative and economic chaos, and with real risk of a grave international crisis.

The Persian Gulf

14. The problems here are parallel to, and closely connected with, Far Eastern problems, except that in the Far East there is no direct and immediate British economic interest comparable to Middle East oil. We have a duty to leave our colleagues in no doubt about the nature of the risks to British interests that are involved here. 40 per cent of Britain's (and over 50 per cent of Western Europe's) oil supplies come from the Gulf and 40 per cent of Gulf oil is in British ownership and make a significant contribution to our foreign exchange earnings. Apart from the Kuwait commitment our position in the Gulf is indivisible. There can be no half measures. A phased withdrawal over two years could lead to an Aden-type situation. An immediate withdrawal would carry

with it the certainty of friction and the probability of hostilities, particularly between Iran and Saudi-Arabia. Repercussions over this could put at risk not only our own, but all Western oil interests in the area. There would be domestic pressure on the Shah to occupy Bahrain. Resistance to such pressures could destroy the stability of his regime and jeopardise the Western connection. But if Iran occupied Bahrain Her Majesty's Government would find themselves ranged against her at the United Nations and generally, and our oil and other interests would be again endangered. Meanwhile, the Russians would take advantage of the situation (as they are already doing in Iraq, by arranging a political purchase of oil they do not economically need). If their initiative were successful our oil supplies could be ultimately under indirect but effective Russian control.

15. In order to guard as much as possible against the foregoing our action in the Gulf should be:-

- (a) To give up the Kuwait commitment at a very early date to be determined in discussion with the Amir.
- (b) To withdraw wholly from the Gulf by the same date as the Far East withdrawal, i. e. 31st March, 1972.

Publicity: The Far East and the Gulf

16. The problem is the same we faced last July; but now it is in a heightened form. Our best chance for a successful consultation with our allies (who will be fearful of the effects of publicity upon stability in South East Asia and the Gulf) would be if we announced on 16th-17th January no more than that our defence plans are under stringent review; that the decisions published last July have had to be re-examined; that to produce meaningful savings substantial changes are needed involving consultations; and that these are proceeding urgently.

17. This would keep down to the minimum the risk of doing irreversible political and economic damage to ourselves and others abroad. But we recognise that to continue to make no announcement of oversea and defence cuts would not be understood at home and could cast doubt on the firmness of our intention to set our economic house in order.

18. In the last resort, therefore, and provided the date of final departure is accepted as 31st March, 1972, we would be willing to put to our Commonwealth partners and allies a form of announcement which made specific reference to this date for the Far East while, because of the high stakes and grave risks, preserving secrecy on the Persian Gulf other than Kuwait.

The Gulf. Consultation

19. We shall need to consult the Shah, King Faisal and the Amir of Kuwait in advance of any statement we may make, and we shall also need to reassure the Rulers of the Gulf States. In the light of the personal assurances given by the Minister of State on his recent visit to the area, and of the post-devaluation messages sent to a number of Governments, we are considering whether a Ministerial visit would be desirable.

20. The Foreign Secretary, who leaves London on Saturday, 6th January, for a visit to Japan, will return via the United States. He will have consultations with Mr. Rusk, the United States Secretary of State, in San Francisco on Saturday, 13th January. He will be back in London on Monday, 15th January.

21. The Commonwealth Secretary has arranged to visit Kuala Lumpur, Singapore, Wellington and Canberra between 5th and 14th January.

22. The purpose of the Commonwealth Secretary's visit would be to explain in general terms the background of the economic reasons for the decisions, making it clear why there have to be cuts both in the domestic and in the external field. If this course were approved, he would go on to state that the Government have decided that the rundown in the Far East must be accelerated and would inform Commonwealth Governments of our intentions, including our readiness to discuss a revised aid programme, our continuing general capability (located in Europe) after withdrawal and our new approach to the Anglo-Malaysian Defence Agreement. He would explain that we envisage our membership of SEATO continuing, on a restricted basis. He would make it clear that the final decision would be taken at a Cabinet meeting on 16th January with a view to an immediate public announcement thereafter, and that he would be returning for that meeting in order to convey any views which Commonwealth Governments wished to express.

23. We should inform the Thais, Filipinos and Pakistanis (as our partners in SEATO and Pakistan's case CENTO also) before the announcement is made. We should also inform Canada and our other NATO partners.

Other Areas

24. (i) Mediterranean

(a) Cyprus

Assuming we shed the Kuwait commitment we should reduce the number of our aircraft in Cyprus. Earlier in 1967 we took preliminary soundings with our CENTO partners about a possible reduction, and they appeared to accept it.

It would not be practicable to withdraw from Cyprus in 1968 or 1969 since -

- (i) It is needed as a staging post until withdrawal from the Far East is complete.
- (ii) This could lead to the collapse of CENTO with grave effects on our relations with Iran and unforeseeable consequences for the stability of the regions.
- (iii) It would decrease the chances of a settlement of the Cyprus problem where we are playing the kind of role in collective peace-keeping which it is generally agreed we should continue to sustain.

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(b) Libya

We should try to re-shape our treaty commitment so as to ensure a longer warning period. But if we go back on the commitment we should imperil arms orders estimated at up to £250 million over the next five years and a highly important source of oil supplies West of Suez.

(c) Malta

We have a defence agreement with Malta until 1974 and have already negotiated the fastest possible rundown of British forces there.

(d) Gibraltar

In the present political climate it would not be possible to withdraw the garrison from Gibraltar, although it cannot be justified militarily.

Other Areas25. (ii) Elsewhere

A thorough study has been made of all our lesser commitments. These mainly affect our dependent territories. We are willing to discuss possible savings with the Chancellor, but these may not be substantial, and do not raise questions of major policy, with the possible exception of discontinuing the Beira patrol. These commitments include responsibility for military protection and evacuation of British nationals in Africa and the Middle East; the defence and internal security of Mauritius after independence; protection and defence of the Falkland Islands; the garrison in British Honduras; our obligations to Brunei; and Fiji which in the worst case requires a brigade group to be committed. But we must remember that we are legally and morally responsible for the defence of our dependent territories. This will continue to be an essential part of our peacekeeping role in the world and will make it necessary for us to maintain a general capability.

Conclusions

26. The effect of cuts on the foregoing scale will be severely to diminish British influence overseas, and their consequences will be unpalatable. In the worst case we might see a Communist Singapore, and a Persian Gulf whose oil supplies were either in chaos or under Russian control. The reactions of the United States which were made last July, will be even stronger, particularly since their problems in Vietnam will make it hard for them to take remedial action elsewhere in South East Asia; and, since our own position in the Gulf is unique, they cannot replace us there. Given our economic situation, heavy cuts seem inevitable, and the price is bound to be severe. But the more successful our consultations, and the smoother the transition, the less damaging the consequences will be.

27. If our recommendations on overseas policy are accepted we are advised by the Secretary of State for Defence that he could see his way to making further substantial savings. Leaving out of account transitional payments the Defence Secretary's preliminary, broad estimate is that budgetary savings of between £50 million and £80 million should be achieved in 1969-70, thereby reducing the defence budget in that year to, or a little below, the level achieved in 1968-69 after the £110 million devaluation cut had been made, and of about £150 million by 1972-73 which would result in a Defence Budget total of about £1650 million in 1972-73 at 1964 prices.

28. Against this background, our recommendations for cuts in commitments are that we should:-

- (i) decide to withdraw altogether from our bases in Singapore and Malaysia by 31st March, 1972, and announce this decision to Parliament in the third week of January, 1968. There would have to be consultations beforehand with our Commonwealth partners and the United States;
- (ii) decide to withdraw wholly from the Gulf by the same date as the Far East withdrawal, i. e. 31st March, 1972, but not announce this decision;
- (iii) decide to give up the Kuwait commitment at a very early date to be decided in discussion with the Amir;
- (iv) subject to (iii), reduce the number of our aircraft in Cyprus;
- (v) reshape our treaty commitment in Libya;

We should also:-

- (vi) examine the possibility of shedding:-
 - (a) responsibility for military protection and evacuation in the Middle East and Africa;
 - (b) the commitment for defence and internal security of Mauritius after independence;
 - (c) the British Honduras garrison;
 - (d) the protection and defence of the Falkland Islands;
 - (e) our obligations to Brunei;
 - (f) the Beira patrol.

We should also:-

- (vii) examine the scale of our military support for internal security in Fiji.

G. B.
G. T.

Foreign Office, S.W.1.

3rd January, 1968

