

CONFIDENTIAL

PRIME MINISTER

NOT USED
BUT PLEASE KEEP

MEETING WITH THE FOREIGN AND COMMONWEALTH SECRETARY AND CHIEF SECRETARY,

17 JULY

ON FILE

You agreed to hold the meeting to resolve three problems.

I. Exchange Rate Fluctuation and Overseas Inflation

A very high proportion of FCO expenditure is overseas. When exchange rates move against them, they have a major problem. This year they expect a £16 million shortfall, about three per cent of their vote.

For this year, Geoffrey Howe wants an assurance that what he cannot find from savings will be met from the central reserve. He has proposed a form of words (A). The Chief Secretary agrees to deal with this 'in a practical way' but will not guarantee that the FCO will at the end of the day get the whole sum.

For the future, Geoffrey Howe wants to be able to make a base-line adjustment to take account of exchange rate fluctuation. This could be either upwards or downwards. The Chief Secretary considers that if it is upwards, it should be treated just like any other bid for additional expenditure.

Agreement could probably be reached on a symmetrical system ie if the FCO gain from exchange rate fluctuation, they give the money back. You told Sir Geoffrey Howe this seemed sensible.

II. Diplomatic Estate: End-Year Asset Recycling

Geoffrey Howe reckons the Diplomatic Estate could be better and more economically managed if he had freedom to make full use of receipts from sales of property wherever and whenever they occur, rather than have to handle each project in a narrow annual and geographic compartment. In practice this would mean paying receipts into a special account in fat years which could then be drawn upon in lean years.

/The PAC

The PAC have endorsed the "idea of enabling receipts from dispersals to be used to finance further estate rationalisation". The Chief Secretary is prepared to agree to allow predicted receipts to be used in the year in which they arise: but insists upon treating unpredicted receipts on a case by case basis.

When you discussed this earlier with Sir Geoffrey Howe, you agreed with his view. It does indeed seem the only sensible way to run what is really a business. It is the way the Crown Estates Commissioners do it.

III. Embassy Sites in Moscow and London

A prime case where such flexibility would be useful arises over the new Moscow Embassy. The FCO offer to chip in receipts from sales over an extended period but cannot guarantee in advance in which year those receipts would arise. They might need to be "carried" by the Treasury in some years, but would make it up in others. They also need an assurance of additional money of something like £3 million a year extending beyond the current PESC framework. The Chief Secretary is unwilling to give a commitment.

One possible solution to problems II and III above would be to make the Moscow Embassy case a trial run for the asset recycling exercise.

CDP