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CONFIDENTIAL

FROM: CHIEF SECRETARY
DATE: 20 July 1984

PRIME MINISTER

FCO EXPENDITURE

I thought it might be useful to set down my views on the points raised in Geoffrey's minute of ~~11~~ July. Most of these will need to be settled in the course of the Survey discussions in September.

Exchange Rate Fluctuation and Overseas Inflation

I understand Geoffrey's problem. As far as the current year is concerned, I am willing to consider with him as soon as he is ready what action can be taken in the light of the figures he quoted, so that he has a firm basis on which to plan for the rest of the year. I understand his officials and mine have agreed to examine the position in a week or so when the latest figures from overseas posts are available.

In future years, I hope that buying currency forward, while not solving the problem altogether, will be a considerable help. My officials are in touch with the FCO about this. I am also ready to consider in my PES discussions with Geoffrey the impact on his programmes in future years of exchange rate movements and overseas inflation to date.

However, I cannot agree in advance to automatic adjustments for price increases. This would be a negation of the cash planning that Geoffrey himself introduced. (The special arrangement for MAFF to which Geoffrey refers involves demand-determined volume changes which are mainly legal obligations and is not a parallel). The amounts involved for the FCO

are not insignificant, and would become much greater still if applied to defence, for example. We must take account of what we can afford within our total expenditure plans. So I see no alternative to considering the extra costs arising from exchange rate movements and overseas inflation in the annual Expenditure Survey discussions alongside other FCO bids and the scope for savings.

Asset Recycling and End-Year Flexibility

I do not think we can reach a conclusion on this now, as there are no specific proposals on the table. I understood that the FCO were content to continue with the case-by-case approach we have been using, under which several projects are going ahead with Treasury agreement. Any general scheme for asset-recycling is almost certain to add to public expenditure. I am prepared to consider any proposals Geoffrey Howe wishes to put forward, but when they have been formulated I think officials should have an opportunity to examine them first.

London/Moscow Embassies

... I enclose a copy of my letter of 29 June to Geoffrey Howe in reply to his minute of 14 June. I am not disputing the merits of the project provided it can be afforded. Once again what is at issue is whether it would require in addition to Geoffrey's programme. Clearly this has to be considered along with Geoffrey's other bids and the scope for making savings in the Public Expenditure Survey.

I am copying this minute to Geoffrey Howe.

PR

PETER REES

For PO strategy Pt 2