

PRIME MINISTER

TRAINING CHARGES FOR MILITARY COURSES FOR FOREIGN AND  
COMMONWEALTH PERSONNEL

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You saw these papers earlier but asked to see them again after our visit to North America.

In a minute of 29 July the Defence Secretary reported to you the results of a review of these charges. He has concluded (paragraph 5) that except where training is provided specifically for overseas students (when full costs would be charged), the "extra cost formula" should be applied. But where we want to single out particular countries for favourable treatment, either for sales purposes or for broad policy reasons, he will use special funds to reduce the charges actually payable. He seeks OD's agreement to this decision.

You asked for a definition of the terms "full costs" and "extra costs" and for information as to how our charges compared with those of our competitors who sell equipment.

The Defence Secretary's minute of 22 September answers these points.

When we charge "full costs" we recover all costs involved so that HMG makes no long-term loss (or profit). Essentially, this means that indirect costs such as overheads are added to the direct costs.

On the other hand, when we charge "extra costs" we merely charge for items directly related to the instruction of students such as the costs of the instructors and the costs of stores used for the course.

/Comparisons

Comparisons with other countries are not easy to make. Mr. Heseltine's minute states that, out of 11 comparable courses run by the United States in 1981/82, six were more expensive than ours and five were cheaper. The Americans have a system of three price levels ranging from something like our full costs, (for Western countries) to much lower costs for developing countries. France tends to bear the basic training costs of students from developing countries but may in some circumstances ask richer developing countries to meet some of the cost.

You will wish to be aware of the Chief Secretary's views in his letter of 13 October (attached) Flag A. He argues that "extra costs" should be redefined so as to be closer to "full costs" (he calls these "long run marginal costs") and that if we do not do that we shall be subsidising these courses to the tune of £45 million. But he does not seem to be pressing the point very hard, presumably because the cost will have to be met from within the defence budget.

Do you agree with the Defence Secretary's conclusions in paragraph 5 of his minute of 29 July (Flag B)?

A.J.C.

Yes  
no

14 October 1983

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10 DOWNING STREET

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MULT

From the Private Secretary

17 October 1983

Foreign and Commonwealth training charges

In his minute of 29 July your Secretary of State informed the Prime Minister of the conclusions of his review of the level of our charges for military training. The Prime Minister asked for a more detailed definition of the terms "extra costs" and "full costs" which was provided in your Secretary of State's minute of 22 September.

The Prime Minister has also seen the Chief Secretary's minute of 13 October on this matter.

In the light of these papers, Mrs. Thatcher agrees with Mr. Heseltine that, except where courses and training are provided specifically for overseas students, our charges for foreign and commonwealth students should generally be at the level produced by our present extra cost formula. She further agrees that when we wish to single out particular countries for favourable treatment, either for sales purposes or for broad policy reasons, the defence policy and defence sales funds should be used to reduce the charges actually paid.

I am copying this letter to the Private Secretaries to other members of OD and to Sir Robert Armstrong.

A. J. COLES

Richard Mottram, Esq.,  
Ministry of Defence.

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Michael Heseltine MP  
The Secretary of State for Defence  
Ministry of Defence  
Main Building  
Whitehall  
LONDON  
SW1A 2HB

13 October 1983

*Dear Secretary of State*

FOREIGN AND COMMONWEALTH TRAINING CHARGES

Thank you for your minute of 22 September.

My letter of 5 August was written on the understanding that you were reviewing your "extra costs" formula in order to achieve a level of recovery more in line with long run marginal costs (LRMC) so as to avoid future subsidy. I now understand that your present purpose is to establish the approximate extent to which your present "extra costs" charges fall short of LRMC ie. what level of subsidy is implied by your proposal to continue to charge only "extra costs".

My preference would be to avoid charging below the level justified by LRMC but failing that to keep the charge as close as possible to that level. I note your view that this would not be practicable in terms of the policy and commercial objectives which training of overseas students is designed to achieve. But the cost of a general concession based on "extra costs" charges could be very large. If full costs are taken as a proxy for LRMC - which is a recognised accounting practice in most cases where a service is provided on a continuing basis - you should be seeking to recover (on the 1982/83 figures quoted in the France Report) £79 million instead of the £34 million (43%) generated by "extra cost" charges. This indicates an annual level of subsidy of £45 million - a very substantial price to pay in order to meet the policy and commercial objectives to which you refer. Can this really be justified given present public expenditure priorities and our problems in meeting your current defence budget bids? Ought we not to be considering instead how far we can reduce this subsidy as a contribution to financing more urgent needs?

I assume of course that any continuing subsidy will be found from within agreed future defence budget provision. It will of course be too large to be charged to the Defence Policy and Sales Fund along with the selective further subsidisation referred to in paragraph 5 of your minute of 29 July.

I am sending copies of this letter to the Prime Minister and other members of OD, and to Sir Robert Armstrong.

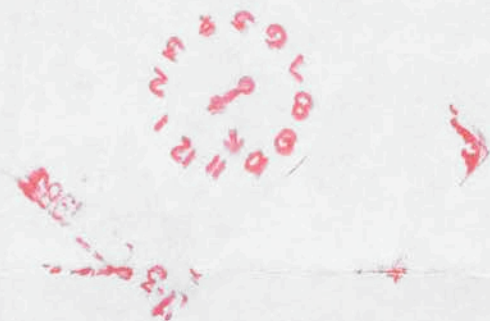
Yours sincerely

J. G. G. G.

for PETER REES

[Approved by the Chief Secretary]

Defence  
Budget, pt 10





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CHIEF SECRETARYFOREIGN AND COMMONWEALTH TRAINING CHARGES

Thank you for your minute of 5th August. I am grateful for your sympathetic reception of the proposals in my minute of 1st August to the Prime Minister, and I note your provisos.

*I think this means 29 July*

2. It is not my intention to generate a hidden subsidy. As I believe the Treasury accept, to define and calculate long run marginal costs (LRMC) is difficult. But we have been working on the problem to see whether an acceptable rule of thumb can be devised for producing a broad assessment of LRMC. If such a measure is practicable and shows LRMC to exceed the price we charge, I would certainly expect Parliament to be informed in the appropriate fashion.

3. With regard to your first proviso, my view is as stated in my minute to the Prime Minister. I do not regard it as practicable, in terms of the policy and commercial objectives which our training of overseas students is designed to achieve, to seek to increase charges above the level produced by our present extra cost formula.

4. I am sending copies of this minute to the recipients of yours.

*WJH*

Ministry of Defence

22nd September 1983

Defense  
Budget  
Pt 10.

24 SEP 1983

