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MR POWELL

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FCO EXPENDITURE: EXCHANGE RATE FLUCTUATIONS

It is a pity that the Prime Minister has to be troubled with this disagreement between Geoffrey Howe and Peter Rees.

Geoffrey Howe has put forward some good arguments:

- the sums of money involved are modest
- erratic exchange rate movements should not disrupt the operation of our embassies abroad
- when the exchange rate was strong the Foreign Office surrendered some of the benefits as underspend.

Peter Rees is defending the principle of planning expenditure in cash terms. If the value of money changes, Departments should adjust the amount of goods and services they buy, not ask for more cash so they can buy the amount they originally planned. And adjustments of this kind should not be ruled out in embassies abroad - if the pound weakens against a currency there may be fewer tourists, for example, and hence less need for Consular support. Geoffrey Howe is asking for the assurance that the volume of FCO

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expenditure need not change at all as a result of exchange rate movements.

Possible Compromise

A compromise which gives Geoffrey Howe most of what he wants but limits the risk that it will be used as a precedent to weaken cash planning in other areas is as follows:

- "The Prime Minister does not wish to see any breaches of the principle of cash planning. But she thinks that the Treasury should recognise the special circumstances of the Foreign Office. She suggests therefore that additional bids as a result of exchange rate changes should be treated as reflecting revised economic assumptions rather than policy changes. This treatment should not prejudice finding some offsetting savings if possible."

The problems of asset recycling and the Moscow site are surely best resolved bilaterally by the Ministers concerned.

David Willetts

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