E.R.

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CDP

PRIME MINISTER

FCO: Overseas Risen Costs

You suggested that the Treasury and FCO Permanent Secretaries get together to look at this problem and produce a paper on the issues for Ministerial decision.

The paper is attached. There is to be a meeting on Tuesday with the Chancellor, Foreign Secretary, Chief Secretary, Peter Middleton and Antony Acland.

Although every inch of the paper has been fought over, it does nothing to bring a solution any nearer.

The FCO say they must have the extra overseas costs due to currency movements and overseas inflation - amounting to £25.4 million in 1985/6 and £26 million in 1987/8 - restored to their budget. Otherwise they will have to make swingeing cuts in our representation overseas. We should no longer have a 'world-wide diplomatic capability'. We would lose credibility with the Americans.

The Treasury say that this is rubbish, that the Foreign Office must cope with unexpected factors like any other department and that the necessary savings to offset the overseas price effect can be found without resorting to the scale of cuts suggested by the FCO. Any adverse effect on the FCO programme from overseas price movement should be treated in the usual way as an additional bid.

In short, exactly the argument as you tried to adjudicate last summer and again in the PES round.

[To follow] I attach the Policy Unit's views.

My only comment is that there is little point in another candle-ends exercise or the sort of horse-trading which ends up with the FCO getting a proportion of its money. Either we decide to go on being represented in the great majority of countries and go on providing the same services as now: in which case it must be done properly. It has to be assumed that this was the intention of Ministers when they originally agreed the sums for the FCO which were subsequently eroded by Overseas Risen Costs.

Or you take a considered decision to reduce the scale of our overseas representation and the services provided. In which case the word can go out to make very substantial economies. The result would be an overseas effort concentrated on fewer countries and fewer tasks, though there would be scope - and need - for reductions in our bigger missions as well.

The worst solution would be to go on as at present: trying to maintain the present level of overseas representation without enough money to do it properly as a result of uncertainty as to how much of your budget is going to be pre-empted by unpredictable currency movements.

Would you like me to show the paper to Sir Robin Ibbs to see if he has some comments? Yes please MT

C.D.P.

29 March 1985