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FILE Defence SW.



bcc: J. Vedder

10 DOWNING STREET

From the Private Secretary

22 March, 1982

Dear Nick,

Germany: Local Overseas Allowance

Many thanks for your letter of 22 March to which was attached a factual note on local overseas allowance (LOA).

I have shown your letter and its attachment to the Prime Minister. She now no longer wishes to defer a decision on this matter until the mooted OD discussion, and has agreed that your Secretary of State may go ahead as he proposed in paragraph 6 of his minute to the Chancellor of the Exchequer of 15 March. As I explained to you on the telephone this morning, the Prime Minister is not now herself proposing an OD discussion of this matter; nor, on the other hand, is she ruling one out, if your Secretary of State or any other OD colleague desires one.

I am sending copies of this letter to the private secretaries of the other members of OD, and to David Wright.

Yours sincerely,

Michael Schelen

N. H. R. Evans, Esq.,  
Ministry of Defence

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10 DOWNING STREET

(1)

Prime Minister

Germany: Local Overseas Allowances

You asked for a paper on  
how these allowances work.

I attach same.

Do you

(i) still wish to defer a decision  
until after an OD discussion?

OR

(ii) now agree with Mr Nott and the  
Chancellor? *Yes Mr.*

MUS 22/3





Prime Minister

dc sv

(2)

The Chancellor still wants

Treasury Chambers, Parliament Street, SW1P 3AG

an OD

01-233 3000

disburse

25 March 1982

N. Evans, Esq.,  
Private Secretary,  
Ministry of Defence

MUS 25/3

MT

Dear Nick,

GERMANY: LOCAL OVERSEAS ALLOWANCE

Following Michael Scholar's letter of 22 March the way is now clear for your Secretary of State to implement the first stage of reductions in LOA in Germany from 1 April. However the Chancellor's acceptance of the implementation of the first stage was without prejudice to agreement either on the final amounts, or on phasing, or on the treatment of new arrivals (the Chancellor sees no reason why servicemen who are starting on a new tour in Germany should be overcompensated for the present extra cost of living by being allowed to receive LOA based on the old rates).

The Chancellor would not press for these matters to be finally settled before 1 April, but he thinks they do need further consideration in OD in the light of the points made in paragraph 2 of his minute of 19 March, and with a view to the completion of this review in the autumn as your Secretary of State proposed. In the meantime he thinks the changes from 1 April, giving phased reductions of £17 million in the first year, should be announced in a way which does not prejudice the outcome of that consideration.

Copies to Private Secretaries of the Prime Minister and other members of OD and to Sir Robert Armstrong.

Yours ever  
Peter

P.S. JENKINS



15 MAR 1982





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*Defence K. J.V.*

*Mr Coles AR 25/3*



*Oh dear*

Foreign and Commonwealth Office

*MUS 25/3*

London SW1A 2AH

24 March 1982

*Dear Madam,*

Local Overseas Allowance (LOA)

Lord Carrington has seen the exchange of minutes begun by the Secretary of State for Defence on 15 March, which is of particular interest to us because of the repercussions which phasing of LOA might have on its Civil Service equivalent the Foreign Service Allowance (FSA) (as you know a special FSA inspection is currently being conducted in Germany, precisely in order to make the LOA cuts more palatable to the Services). He did not think it necessary to weigh in in writing before the expected meeting of OD; and, given the tight timetable, he is content with the decision recorded in your letter of 22 March.

I shall be grateful if you and the other recipients of this letter will continue to bear in mind our interest in any proposed changes in the level or application of LOA.

I am sending copies of this letter to David Omand (MOD), John Kerr (HM Treasury) and David Wright (Cabinet Office).

*Yours ever*

(B J P Fall)  
Private Secretary

M C Scholar Esq  
10 Downing Street

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MINISTRY OF DEFENCE  
 MAIN BUILDING WHITEHALL LONDON SW1

Telephone 01-9307822 218 2111/3

MO 3/9

22nd March 1982

Dear Michael,

GERMANY: LOCAL OVERSEAS ALLOWANCE

I attach a factual note on local overseas allowance (LOA) on the lines which you suggested might be helpful to the Prime Minister. You thought she might wish to have such a note in front of her when considering the proposed discussion in OD and the possibility of announcing before that a reduction in present LOA rates from 1 April. It has been shown to the Treasury who are content with it.

So far as this last possibility is concerned, it might be useful to set out briefly the options which we have. They are:

- a. to announce with effect from 1 April the £17M package proposed in my Secretary of State's minute of 15th March to the Chancellor of the Exchequer;
- b. to announce a 10% cut in rates from 1 April without specifying what other cuts, if any, might follow; or
- c. to cut LOA rates by 10% from 1 April, announcing it as the outcome of the November 1981 LOA review; any further changes in LOA would then be dependent on the review proposed for the autumn of 1982.

There is of course the further option of doing nothing on 1 April. As I have explained over the telephone, the main arguments against this are that Servicemen in Germany are expecting a change then, and postponement for one month of a 10% cut in LOA rates in Germany costs £1 million.

The effective choice is between options a. or c., or doing nothing. Option b. would be very damaging both managerially and politically. Servicemen in Germany would be left in complete uncertainty about their future entitlement to LOA, a situation which would be bound to lead to criticism in the Press and in

M C Scholar Esq



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Parliament. As to option a. my Secretary of State who, as you know, is en route to the meeting of the NATO Nuclear Planning Group in Colorado Springs, has said that he would be quite content for colleagues to agree to a 10% cut on 1 April in his absence. But he has indicated that he would want to be consulted again if anything specific is to be said about further cuts later in the year. Option c., while easier managerially and politically, could be even more expensive than simple deferment of the £17M package until 1 May, subject to whatever may be the outcome of the discussion in OD now planned for 1 April. One way or another, we ought to tell BFG tomorrow whether or not there is to be any change in LOA rates at the end of this month.

I am copying this to the Private Secretaries of the other members of OD, and to David Wright.

*Yours sincerely*

*Nick Evans*

(N H R EVANS)

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## LOCAL OVERSEAS ALLOWANCE (LOA)

### The purpose of LOA

1. LOA is a tax-free allowance paid to members of the Armed Forces in addition to their pay to compensate for the essential extra costs of living abroad. It is assessed separately for each overseas theatre by a system designed to measure the extent to which current living costs in that theatre exceed comparable costs in the United Kingdom. The system of assessment was introduced in 1979 by the present Government, replacing a previous system which on the whole was less favourable to Servicemen.

### The assessment of LOA

2. The calculations are made in detail at four reference points (Captain and Corporal, single and married). With the aid of statistical survey, UK budgets are drawn up for these ranks showing their detailed expenditure at current UK prices over a range of some thirty items of personal and household expenditure. Overseas prices and conditions are examined by review teams on which the three Services are represented together with MOD and Treasury officials. They draw up overseas budgets after consultation with the theatre commanders. The overseas budgets are based on the projection abroad of the standards of living permitted in the UK by Service pay with such adjustment as is necessary to reflect local conditions. The difference between the home and overseas budget costings becomes LOA. The system provides for full reviews of prices and standards every three years and for annual updating for price changes alone in the intervening years.

3. Reviews and updatings of the allowance were suspended by MOD Ministers in 1980 pending reappraisal of the assessment system. This reappraisal was carried out jointly by the MOD and the Treasury during 1981. It did not alter the principles of the system but it provided up to date reference data for the UK and recommended

/improved



improved working methods for determining the overseas prices and standards to be reflected in overseas budgets. The guidelines emerging from this reappraisal are attached at Annex A.

The Germany review

4. The review for Germany was one of the first undertaken using the new guidelines and some difficulty has been experienced in reaching an agreed position on the extent to which UK living standards require adjustment to meet local conditions in Germany. The review has however clearly shown that the present rates of LOA there should be substantially reduced and that the existing LOA is tilted too far in favour of married servicemen. The reasons are:

a UK domestic inflation has remained ahead of that in Germany. In consequence the extra costs faced by servicemen in Germany have decreased.

b The new working methods have enabled a better determination to be made of comparable overseas prices and of local factors affecting the standards of living of servicemen there.

5. The MOD recognises that further work will be required to produce a fully agreed outcome. The area of disagreement ranges between positions that would achieve savings of £m24 and £m48 in a full year on the present LOA bill for Germany of £m115. The MOD has proposed that for management reasons reductions should be limited to 10% across the board from 1 April 1982 followed by further staged reductions for married personnel to produce an overall saving of £m17 in 1982/83. This would leave final resolution of appropriate overseas standards for Germany to be settled in the course of the next updating due in Autumn 1982.

/6.



6. It was recognised that personnel may well be entering into new financial commitments on the basis of the present level of their overseas income. Arrangements were therefore made in February to issue an early warning of reduction of LOA from 1 April 1982.

#### Exchange rates

7. Local currency is issued to Servicemen in Germany at fixed rates of exchange (the Forces Fixed Rate - FFR) which are established by the MOD for this purpose in line with the commercial rates of exchange obtaining at the time of LOA assessment. Because this is a fixed rate they are protected from day to day changes in their local currency income due to the effect of exchange fluctuations. But if there is any significant movement of the commercial rate of exchange away from the FFR in between normal LOA updatings the FFR may be realigned. Such realignment is however accompanied by a compensating automatic adjustment of LOA to produce on average the same local currency income as before. In other words, once the average Serviceman's local currency income necessary to maintain the agreed standard of living has been established by an LOA review, FFR and LOA rates together maintain that local income despite changes in commercial exchange rates.



GUIDELINES FOR THE ASSESSMENT OF LOA

1. LOA represents the essential extra costs of living abroad, it is not in whole or in part an inducement for service abroad, or a reward for service in adverse conditions.
2. LOA should be assessed on the basis of a projection abroad of UK standards of living, except in those respects where lifestyle either necessarily or reasonably reflects local conditions or practice according to the application of the factors set out at paragraph 7 below.
3. Each area is to be judged separately on its merits and by appropriate reference to the UK budget and standards; not by reference to standards for other areas. However, where areas are similarly influenced by the factors set out at paragraph 7, some consistency in overseas standards would be expected.
4. The basic expenditure pattern of the UK budget is to be updated at the start of each new review cycle.
5. Local standards for the principal budget items are to be assessed against the yardstick of UK reference standards, which are themselves to be reviewed at the start of each new review cycle.
6. The expenditure allocation of the UK budget is to be updated annually to reflect movements to Service pay.
7. Local standards should be assessed, and variations from the UK reference standards justified, according to the influence on overseas Service lifestyles of the following factors:



- a. Geography and climate, including the effects of (or on):
  - i. Remoteness of accommodation or workplace
  - ii. Inhospitable or dangerous terrain
  - iii. Geographical confinement
  - iv. Working and living conditions
  - v. Domestic and social life, including sporting activity, dress etc.
- b. Economic factors, such as:
  - i. the relative cost and ease of availability of certain goods and services. Where reasonable local alternatives to the UK standard product are judged to exist, these should generally be regarded as suitable substitutes unless there are sustainable reasons for not doing so - eg. effect on morale;
  - ii. availability of service facilities; eg. NAAFI, sports and clubs, leave schemes, etc.
- c. Obligatory requirements of local laws and regulations.
- d. Local social and cultural practice.
- e. The effects of living or working in an international Armed Service environment, eg in day to day co-operation with other NATO or foreign Service personnel.
- f. Length of tour.

8. The rates of LOA at each marker point will be the difference between the assessed total overseas expenditure and available pay. It should not be an over-riding requirement that Officers are paid more LOA than Other Ranks. In no case however, should the total overseas income (available pay + LOA) at the officer marker points be lower than for marker Other Ranks.

9. LOA should be reviewed on site not less than every 3 years, at which time adjustment of standards will also be considered, and updated at least annually in respect of relative price movements."