



Tom B

Would you let me know the def: of "full" and "extra" costs and how they compare with those of our competitors, who sell equipment.

PRIME MINISTER

Pine Martin:

Agree, subject to colleagues views, to retaining about the same level of fees as at present? (Training commitments attracted)

FOREIGN AND COMMONWEALTH TRAINING CHARGES

Defence Budget with FERB?

JF 1/8

In his minute of 1st March 1982 about military assistance and training charges my predecessor set out proposals for making military assistance a more effective instrument of defence policy. Most of those proposals have been put in to effect. A Defence Policy Fund and a Defence Sales Fund have been set up and are operating. The removal of Amortised Training Charges will make British Servicemen less expensive to foreign governments who use our people on loan service or secondment. The machinery for handling all aspects of military assistance has also been improved. The remaining problem is the level of our charges for military training. As you know, a further review of this area was commissioned towards the end of last year.

2. This internal review presented a choice between setting charges normally at the extra cost level or below that level. It recommended that, whatever the chosen level, the use of the Defence Policy and Defence Sales Funds to reduce charges further in specific cases should be considered when policy considerations demanded it. The review also emphasised the need to stabilise our charges, and to explain them consistently to our customers.

3. A parallel study was also made by consultants from the Economist Intelligence Unit (EIU) of the pricing mechanism for overseas training. This study reached broadly similar conclusions, but argued in favour of a two tier pricing system based on full costs and extra costs, whereas our internal study recommended full



costs as a basis for charges only where courses were provided specifically for overseas students. I am sure that our broader interests in fostering the use of our training facilities by overseas students should lead us to favour the latter approach.

4. The factual material assembled by the internal review showed that, despite difficulties, we have had considerable success with the training of foreign and Commonwealth Servicemen. Nevertheless, high inflation in the UK has in the past led to very considerable price increases which produced many complaints particularly when the pound was strong. A greater stability of prices as a consequence of lower inflation should make most of our customers less sensitive to our charges than they have been of late. Nevertheless, there is no room for complacency, and we need a policy that will be both fair and easily comprehensible to our customers.

5. I have therefore concluded that, except where courses and training are provided specifically for overseas students (e.g. flying training), our charges for foreign and Commonwealth students should generally be at the level produced by our present extra cost formula which is well understood by our customers. This will mean in practice that those of our charges that are at present above the extra cost level will be held where they are until movements in costs have brought them in to line; and those below that level will be brought up to it as soon as is consistent with the avoidance of excessive increases. When we want to single out particular countries for favourable treatment, whether for sales purposes or for broad policy reasons, we will use the Defence Policy and Defence Sales Funds to reduce the charges actually payable. I intend to develop these Funds and to apply them vigorously.

6. Any other approach seems to me likely to be counter-productive. In my judgement the level of charges produced by our present extra cost formula is the maximum consistent with the policy and commercial



objectives which our training of overseas students is designed to achieve. To move to any other formula which might tend to push charges up would be self-defeating in political terms.

7. I should be glad to know whether you and our other colleagues in OD agree that I should proceed as I propose in paragraph 5 above.

8. I am sending copies of this minute to members of OD and to Sir Robert Armstrong.

WJH

Ministry of Defence

29th July 1983



10 DOWNING STREET

From the Private Secretary

10 August, 1983

BT/

The Prime Minister has now seen your Secretary of State's minute of 29 July about Foreign and Commonwealth training charges. Before agreeing to the proposal set out in paragraph 5 of that minute, she would like to know the definitions of "full" and "extra" costs to which the minute refers, together with a comparison of our own charges with those of other countries which provide similar training.

I am sending copies of this to Private Secretaries of members of OD and to Richard Hatfield (Cabinet Office).

TIMOTHY FLESHER

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

CONFIDENTIAL

file



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01-215 5147
SWITCHBOARD 01-215 7877

From the Minister of State
for Industry and Information Technology

KENNETH BAKER MP

Rt Hon Michael Heseltine MP
Ministry of Defence
Whitehall
LONDON
SW1

Handwritten initials and date:
CMB
22/8

18 August 1983

Handwritten signature:
Sir Michael,

Thank you for copying to Cecil Parkinson your minute of 29 July to the Prime Minister on Foreign and Commonwealth Training charges. I am responding in Cecil's absence overseas.

For my part, I am content that you should proceed as you propose. The approach put forward in your minute would seem to give the desired flexibility to allow us to make a particularly favourable response in individual cases where wider political or equipment sales considerations merited it, whilst more generally maintaining a reasonable level of charges. Like you, I am convinced of the potential value of training courses in orienting overseas students to British equipment and I know that this is a subject upon which industry itself feels quite strongly. It has, I believe, been raised at the last two meetings of the National Defence Industries Council. At the same time, I wonder whether the opportunity might sensibly be taken when acquainting UK defence contractors with our final decision, to encourage a greater contribution from them either in terms of the training schemes which they offer overseas customers or even, in appropriate circumstances, to the cost of MoD courses themselves?

I am copying this letter to members of OD and Sir Robert Armstrong.

Handwritten signature:
Kenneth Baker

KENNETH BAKER

MA7/MA7ABK

Deference Budget



22 NOV 1988

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG

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

5 August 1983

Dear Secretary of State,

FOREIGN AND COMMONWEALTH TRAINING CHARGES *in the box*

The proposal in your minute of 1 August to the Prime Minister will not cause difficulty for the Treasury provided it is clear that it does not conflict with the Government's fees and charges policy and that it does not generate hidden subsidy.

You are not, I believe, questioning the normal principle which applies in these cases that we should maximise net revenue. If you were, I should be obliged to put forward a vigorous defence of that principle. However, I understand your view to be that in the generality of these training situations it is simply not practicable to maximise revenue above the level of the additional cost incurred by the Ministry of Defence. That of course is a matter for your judgement and your conclusion is in no way inconsistent with existing fees and charges policy. At the same time, it need not preclude charges being maximised above the level of additional cost in circumstances which you would not find inconsistent with your policy and commercial objectives.

However, you will want to ensure that your approach does not give rise to hidden subsidy. This could happen by using the "extra costs" formula your department has used in the past instead of the more usual long run marginal costs (LRMC) formula since in most cases charges based on the former will fall significantly below the direct cost to the Defence Budget. I am told that when our officials discussed this last April it was agreed that your department would review the "extra costs" formula with the aim of achieving a level of recovery more in line with LRMC. We have not yet been informed of the progress of the review. But on the understanding that the "extra costs" calculation which you now have in mind will not produce charges significantly different from the application of the LRMC formula and will not create hidden subsidy, I would raise no objection to what you propose.

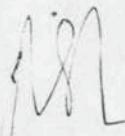
CONFIDENTIAL
1.

CONFIDENTIAL

I agree of course that full costs should be charged where courses and training are provided specifically for overseas students.

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

yours sincerely



for PETER REES

(approved by the Chief Secretary
& signed in his absence).

CONFIDENTIAL

Balance: Budgeter Pt 10

5 AUG 1983
12 1
9 11
8 12
7 13
6 14
5 15
4 16
3 17
2 18
1 19

~