

copied to Oman May 1987 CONFIDENTIAL

Follow up Action
to Mr. Smith & Oman



MINISTRY OF DEFENCE
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MO 24/4

15th June 1981 (1)

Prime Minister

Dear Michael,

As you will see Mr Nott is trying to do something to reduce these charges. Shall I ask for a progress report i, say, September? If the results seem insufficient, you would hold

MOD CHARGES FOR TRAINING AND ASSISTANCE TO OVERSEAS GOVERNMENTS

a ministerial decision?

yes not

And

In the light of your letter of 29th May, and subsequent discussion, Mr Nott has asked me to write to you forwarding a note on MOD's current charging policy for training and other military assistance. The note describes the basis and composition of our charges and mentions the existing arrangements for waiving or reducing charges in particular cases. This is a revised and slightly expanded version of a MOD Note provided for MISC 42, whose report was considered by Ministers early this year. Mr Nott has asked me to draw your attention to para 4 below and the various propositions affecting charges for military training assistance which he is considering.

There have been complaints from overseas Governments (both NATO and non-NATO) in recent years that our training and other assistance have become too expensive. There has also been a decline in the number of overseas students attending courses in this country (a reversal of the upward trend a few years ago). It is difficult to be sure of the reasons for this, since there have been special factors at work, such as the strength of the pound, a world-wide recession, tighter Defence Budgets in customer countries, and the cut-off, for different reasons, of training for Iran and Nigeria (formerly two of our largest customers).

Nevertheless, many traditional and potential customers perceive our charges to be high, and further sharp increases could encourage a fall-off in demand. We therefore need to consider our own interests carefully. The provision of military training and assistance, particularly to countries outside the NATO area, can be an effective way:

- of contributing to stability in parts of the world where we have a strategic or economic interest;

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- of demonstrating a degree of military involvement which is neither expensive nor implies major defence commitments, but which nevertheless is visible both locally and to the Eastern bloc;
- of gaining influence with the armed forces of Third World countries, and promoting the sale of British defence equipment.

Against this background, Mr Nott is considering a number of changes which should have the effect of making British military training assistance more attractive to those countries whom we wish to help in this way:

a. Loan Service Personnel. Officials are considering a new scheme for the provision of advice and training in-country, which would reduce the charge to the receiving Government quite considerably, but preserve HMG's ultimate control over the personnel. Some of the reduction in charge might be found by arranging for payment to be direct and in local currency by the receiving Government to the Servicemen on loan, which would relieve the latter of their income tax obligations to HMG.

b. Flexing of Charges. Mr Nott has decided that we should be prepared to abate our charges in certain cases where to do so would help secure important defence sales or serve defence policy objectives. This might be done by setting up a fund, perhaps financed partly from industry and partly from the Defence Budget, which would establish a defined capability to quote concessionary prices, whilst maintaining a discipline to keep costs down where assistance and training are not subsidised. A fund established thus might deny resources to other defence activities. Furthermore, we should have to be careful to co-ordinate this with the help given from the FCO's UKMTAS budget for wider political and foreign policy reasons.

c. Training Costs. It is clear from the attached note that our present charges for courses in this country recover well below our full costs and little more than the direct costs incurred in the majority of cases. There is considerable evidence that, where valid comparisons can be made, the cost of our training (to Defence Votes

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and the UK taxpayer) is significantly higher than that of our allies or that provided by the civilian sector in the UK. Mr Nott has, therefore, called for urgent action to reduce the cost of our training, and reductions would be reflected in the charges we levy on overseas students. Meanwhile, officials are scrutinizing the costs of individual courses to see whether some planned or possible reduction in the consumption of expensive items such as ammunition would justify a lower charge than that published for this year.

I am copying this letter to Francis Richards (FCO), Peter Jenkins (HM Treasury) and David Wright (Cabinet Office).

Yours sincerely
J D S Dawson

(J D S DAWSON)

DEFINITION OF COSTS AND DETAILS OF
COST ELEMENTS INCLUDED IN MOD CHARGES -- NOTE BY THE
MINISTRY OF DEFENCE

Definitions

1. The definitions of full and marginal costs promulgated by the Treasury are as follows -

a. Full Costs

"The assessment of full cost is intended to ascertain the level of charges to be made which, if they were to be recovered in full, would result in no profit and no loss on the total costs which have been borne on the Vote of the Department making the assessment, on any other Vote, or are appropriate as notional charges in respect of, eg interest on capital, superannuation, insurance, etc."

(Source: Government Accounting P16)

b. Marginal Costs

"Marginal costs are the amounts at any given level of activity by which the total costs are changed if the level is increased or decreased by one unit of output."

(Source: Treasury Guide to Fees and Charges
Annex A para 4)

Cost Elements included in MOD charges

2. At present the MOD charges full costs for loan service personnel, whether funded by the host country or the FCO, on the grounds that UK Servicemen seconded overseas represent a long term loss of trained manpower and that an increase in the size of the Services is required to meet the commitment. The standard elements of charge are as follows:

Pay

Pension and Gratuity Liability

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Loan Service Pay

Separation Allowance (unaccompanied stations only)

Outfit Allowance

Clothing

LOA

Education Allowance

Disturbance, Subsistence, Removals and Storage charges
Movement costs
Unaccompanied Baggage
Postal Concession Charges)
Medical, Dental and Optical Facilities) (where MOD provides)
Higher Formation Charges

* Loss of Interest on Working Capital (now 6%) (representing average delays in payment).

- The majority of these elements constitute payments to the individuals on loan.

3. From 1 April 1980 the following further elements have been included as part of the standard charge -

Entertainment Allowance

* Amortised Ground Training charges

* Amortised Flying Training charges

5% Treasury Contingency

In addition, the following elements are also charged separately where applicable -

Language Training and Awards

General Duty Flying Clothing

Flying Risk Insurance Premium Refund

4. For training carried out in the UK the MOD charges are pitched between marginal cost and full cost. The basic rate applicable to NATO students represents the direct running costs of a course per student head. This is a figure which broadly represents marginal costs, though it may exceed or fall below true marginal costs in particular instances. For non-NATO students a 30% enhancement is added to the basic rate in accordance with Government policy of moving towards a full cost charge. These rates are estimated to be approximately 40% of full costs for NATO, and 50% of full costs for non-NATO students. This enhancement makes a partial contribution to overheads.

5. For ground training the elements of cost making up the basic rate are as follows -

Pay, Pensions and Allowances of Instructional Staff

Consumable Stores (including ammunition)

Public Utilities

* Starred items introduced under pressure from the Exchequer and Audit Department and the Public Accounts Committee.

Maintenance of Instructional Equipment

* Loss of Interest on Working Capital (representing average delays in payment)

5% Contingency

6. For flying training the following additional elements are included in the charge -

Aircraft write off wastage

1st and 2nd line spares

3rd and 4th line spares

Labour costs of maintenance

Petrol, Oil and Lubricants (POL) - excluding duty

Third-party compensation (nominal)

Ground personnel (excl training costs)

Maintenance and operation of associated ground equipment

Aircrew

Aircraft Depreciation

Starter cartridges and braking parachutes

7. In both cases the following elements would need to be included to bring the present charges up to full costs:

Administrative Staff

High Formation Costs

Equipment Support

Depreciation of Buildings

Amortised Training Costs of Instructors

Interest on Capital

GENERAL

8. All costs are calculated by professionally qualified accountants on a standard accountancy basis.

REVENUE

9. Receipts by MOD in respect of training and LSP in 1981/2 are estimated at £60M. This is not 'profit'. It broadly covers costs, plus a small contribution towards MOD overheads. A reduction in these receipts without any compensating increase in the Defence Budget would require offsetting savings to be made.

EXISTING ARRANGEMENTS FOR WAIVER OR REDUCTION OF MOD CHARGES

10. The bulk of the training provided by the MOD is charged to recipient countries. However, the FCO funds some or all of the training provided for certain poorer countries under the UK Military Training Assistance Scheme (UKMTAS), for which provision is made annually on FCO Votes. In addition, the MOD has delegated authority from the Treasury to waive or reduce charges for training related to a specific defence sales contract (where the revenue to MOD Votes equals or exceeds the amount waived).

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June 1981