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cc: [signature]

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

F E R Butler Esq
10 Downing Street
London SW1

1 April 1985

Dear Robin,

The Chancellor has suggested that, in advance of this afternoon's MISC 111 meeting, the Prime Minister might find it helpful to have a quick preliminary assessment of the overall public expenditure situation which is likely to confront the Cabinet in the 1985 Survey, so as better to judge the scale of social security savings which are needed.

It is, of course, very early indeed to be assessing how the 1985 Survey might go. But with the Budget now behind us, the Chancellor and Chief Secretary are getting some first pointers; the more they see, the more they think that the Survey will be tough.

For 1986-87 the Reserve now stands at £6 billion. One of the key decisions for July (more so than in earlier Surveys) will be the size of the Reserve to plan for announcement in the 1986 White Paper. This, coupled with a decision on the planning total, will fix the room for manoeuvre on programmes during the bilaterals.

By July we shall still have little idea about how 1985-86 is going, and, in particular, whether the enlarged, £5 billion, Reserve provides an adequate safety margin. We shall know more about coal; but, given what Ministers have said about the need for adequate Reserves, it would be difficult - and probably imprudent - to plan for a Reserve for 1986-87 less than £5 billion. So, for present purposes, the assumption should be that Ministers will be aiming in July for a Reserve of £5 billion.

That would mean that a net £1 billion (£6 billion less £5 billion) could be added to 1986-87 programmes. Developments already in view show that irresistible bids will, as in earlier



years, be substantially more than that. Temporarily higher RPI and interest rates will, in one blow, add around £800 million mainly on social security. On local authority current, depending on decisions about targets, we could well have to contemplate an addition of around £500 million to the very tough White Paper figures. So we are already well over £1 billion - and there is no doubt there will be other pressing claims.

That in turn means that Ministers will need to agree cuts in the Survey. But where from?:

- Defence: with higher inflation in 1985, there will be a struggle to make the present cash figures stick: and a greater struggle still to achieve a larger real terms fall than the existing figures already imply;
- FCO/Aid: our problem is to make last year's figures stick (the Foreign Office have been trying to unpick them ever since they were agreed last October);
- Agriculture: again, the main task will be to stick to last year's provisional figures. Beyond these, at best perhaps a few tens of millions in cuts, and the IBAP figures can easily go up in hundreds;
- Industry: again, cuts in two rather than three figures;
- Nationalised Industries: the White Paper already assumes large efficiency improvements and a financial turn-around; we will probably be doing well to hold the industries to these figures (unless price increases - eg on gas - are agreed);
- Employment: no hope of cuts here;
- Housing: The Gregson report does not offer much prospect of further large cuts;
- Transport: would mean taking on the infrastructure/roads lobby again;
- Law and Order: outside the local authority sector the sums at stake are very small, except on prisons;
- Education: only universities and student grants outside the local authority sector;
- Health: sizeable cuts would require options not considered acceptable last year;
- Others: all pretty small.



CONCLUSION

In summary, the Chancellor and Chief Secretary believe that a difficult Survey is in prospect. We shall not know enough about the 1985-86 outturn by July, and perhaps by October, to be able to drop below the Budget Reserves of £5 billion, £6 billion, £7 billion safely and convincingly; so cuts will be needed. Given the great difficulties of extracting sizeable cuts from programmes generally this year there is the strongest case for securing the maximum feasible savings from social security - including £600-£700 million in 1986-87 from freezing the unpledged non-statutorily updated benefits in the November 1985 uprating.

Yours sincerely,

Philip Wynne Owen.

PP.

MISS M O'MARA