EXCESSIVE
TAXES

LEAD TO 'STAG-FLATION'

EXCESSIVE TAXES ON THE INCOME FROM THE PRODUCTION OF GOODS AND SERVICES (EXCLUDING RENTIER INCOMES) LEAD TO 'STAG-FLATION'.

This is the conclusion reached from an analysis of the official statistics of the division of the Income from Production of goods and services between Taxes, Net Disposable Profits, and the "take-home pay" of Wage-and-Salary-earners.

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The analysis of official statistics relating to the division of the national income from goods and services (as distinct from rentier incomes) was commissioned by the Economic Research Council but members of the Economic Research Council are not necessarily committed to the conclusions which have been drawn from this analysis.

EXCESSIVE TAXES LEAD TO 'STAG-FLATION'

CONTENTS

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EXCESSIVE TAXES LEAD TO 'STAG-FLATION'

INTRODUCTION

Stag-flation is the new "in" word to convey the unhappy situation of industrial Stagnation combined with Inflation.

Stag-flation is an ugly word but we have used it because it so aptly conveys the ugly situation in England where we have stagnation combined with growing Unemployment in spite of Inflation.

In 1968 the Economic Research Council sponsored the first of a series of papers under the title "A Programme for National Recovery". The object of that paper was to clear the air of confusion which had arisen as a result of public statements about the cause of rising prices.

It was widely believed that full-employment—or as some people called it over-full-employment—had placed labour in such a favourable bargaining position that it could secure excessive wage increases from employers, generally starting with the nationalised industries, which employers were obliged to pass on to the public in the form of increased prices.

Statements in the House of Commons made it increasingly difficult to judge whether this belief was well founded. For example, the then Prime Minister stated in the House of Commons that "in 1965 we paid ourselves increases in money incomes of about £1,800 million compared with the previous year. About £1,300 million of this represented increases in wages and salaries. Over the same period we earned only £600 million by way of increased production".

This was Startling, but investigation revealed that the then Prime Minister was comparing increases in money Income at Current Prices with increases in Production valued at constant 1958 prices which, of course, were not comparable so we thought it would be helpful to publish a *summary of comparable official statistics which would show* the true position.

At the time we were inclined to agree with the general proposition that over-employment had enabled labour to secure an excessive slice of the Cake. This proposition was embodied in a general theory of "wage-push" Inflation.

According to this theory, Inflation is a rise in prices which occurs when the demand on the labour market is so excessive as to reduce Unemployment to a level at which Trade Unions are able to force up wages etc. more than is compatible with the increase in productive capacity.

The theory went on to assert that Inflation occurs when Wages increase by more than 3 per cent per annum, which was the rate of growth of Production, and that the level of unemployment which corresponds to a 3 per cent rise in wages was between 2 and 2¼ per cent. It concluded that in order to prevent Inflation it would be essential to reduce Demand to the extent necessary to keep Unemployment just above 2 per cent.

In short the "wage-push" theory, which was widely accepted by those in Authority, required that unemployment should deliberately be maintained at 2¼ per cent and that this figure should be used as a guide to decide whether the economy should be expanded or contracted by Government action.

When we analysed the statistics we were surprised to find that the overall increase in Real Wages had, in fact, lagged behind the overall increase in Prices instead of pushing ahead of Prices and so forcing them up as was generally believed.

We also drew attention to the fact that the principal remedy officially recommended as a cure for Inflation was to increase Taxation, particularly taxes on industry, which it was believed would reduce demand—but that in fact this had not achieved its purpose.

We concluded that the whole idea that the State can reduce Demand by using taxes to take purchasing power away from the Private sector, is completely unrealistic if the State itself spends the whole proceeds of the additional taxation. Total Demand is not diminished by this device. Demand is simply transferred from the Private Sector to the Public Sector.

Times have changed since we published that paper in 1968. We no longer have full employment; indeed, we have serious Unemployment. Yet Prices and the Money Supply

have continued to rise. So we thought it would be useful, once again, to examine the relationship between Real Wages—that is to say, "take-home pay"—and Prices so as to provide a reliable basis for considering any plans which may be put forward for increasing Demand and reducing Unemployment.

Once again it emerges that "take-home pay" has lagged behind Prices, so we have gone further into the matter and investigated how the Cake of Total Income from the Production of Goods and Services (excluding rentier incomes) has been divided between Taxes, Profits, and "take-home pay". We show the result expressed as a percentage of the total Cake.

The Cake, of course, has increased in size over the years and so all three slices have increased in size, but the important facts which have emerged are that, contrary to general belief, the slice of the Cake which has gone in "take-home pay" has remained virtually unchanged—if anything, it has slightly diminished. The slice taken in Taxes has greatly increased—it has nearly doubled during the last ten years. The slice remaining in the form of Profits has been greatly reduced.

We then summarise the official figures for the increase in cash held by the public on deposit with banks, and building societies etc. which shows that an increase in the Money Supply does not necessarily lead to an increase in Demand and we point out that the effect of increasing taxes on industry has left industry with less money for expansion and has discouraged manufacturers from taking risks, and that those taxes and levies which are linked to wages have increased the cost of employing labour with the result that manufacturers go to ever increasing lengths to avoid employing labour.

This led us to tabulate Taxes on industry against Unemployment. The result suggests that there may be a significant correlation between the two.

We conclude this paper by suggesting that since Taxes and levies on industry seem to be the principal cause to "stag-flation" they could be reduced by some £2,500 million a year which would restore confidence; encourage industrial expansion and probably lead to a significant reduction of unemployment if the Government was willing to revert to the pre-war policy of meeting public Capital expenditure out of long term Borrowing from the private sector instead of out of Taxes as at present.

All the statistics used in this paper are derived from official publications. We hope that the paper will help those who are now seeking a solution to the surprising and unpleasant predicament in which we simultaneously face Rising Unemployment and Increasing Inflation.

Taxes

Total Taxes paid in Britain increased by about 100 per cent between 1964/70 while the G.D.P. at current factor price increased by less than 50 per cent. (See Table 1.)

TABLE 1

TOTAL TAXES IN RELATION TO G.D.P.

£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Total taxes paid to public authorities:							
Taxes on income	3,522	4,021	4,419	5,083	5,631	6,321	7,429
Taxes on expenditure (incl. S.E.T.)..........	3,362	3,758	4,237	4,529	5,391	6,194	6,636
Local authority rates ...	1,096	1,228	1,374	1,467	1,548	1,666	1,822
National Insurance etc. contributions	1,444	1,685	1,804	1,909	2,165	2,244	2,655
Taxes on capital...........	308	290	315	339	439	637	659
Total taxes paid..............	9,732	10,982	12,149	13,327	15,174	17,062	19,201
Gross domestic product at current factor cost	28,984	30,972	32,718	34,558	36,634	38,576	42,307
Taxes as percentage of G.D.P.	33.6 %	35.4%	37.1%	38.6%	41.4%	44.2%	45.3%

Source: 1971 Blue Book, tables 1 and 49.

The figures for 1971 are not yet available but provisional figures for the first nine months indicate that the total taxes which will be paid in the calendar year will again be more than in the previous year. New fiscal measures may have reduced the annual increase but taxes as a proportion of G.D.P. probably remain unchanged.

These vast tax increases were originally said to have been imposed:

(a) To syphon off Excess Demand, and

(b) To put right an adverse balance of payments.

In 1965 the Chancellor of the Exchequer, Mr. Callaghan, said in his Budget Statement, "I have concluded that we must act so as to reduce home demand . . . by £250 million at an annual rate." Other Chancellors have referred to the need to "blow off the froth", etc., yet the additional taxes did not reduce Demand, they merely transferred Demand from the Private to the Public Sector and did nothing to curb inflation.

We can find no statistical evidence to support the claim that the swing to a favourable balance of Trade in 1969/70 was brought about by the restrictive measures imposed since 1965. On the contrary the statistics show that Britain's balance of external trade in goods and services oscillates with a rhythm which follows closely the cycles of World trade.

Because the British economy and its banking system are deeply involved in World trade, the domestic economy cannot be insulated from the powerful forces which generate the cyclical variation of World trade. In our view, therefore, it is beyond the power of Government, by any practical means, to alter the period of the oscillations of the country's external trade balance or to produce at will a swing from deficit to surplus. (These findings were published in Research Paper No. 3, in the series "A Programme for National Recovery", January 1969*.)

The official justifications for successive additions to Taxation were, in our view, unsound. The Taxes which now oppress the Private Sector did not reduce Demand or halt Inflation. All they did was to undermine confidence which was further weakened by continuing Inflation and eventually be mounting Unemployment.

*The Balance of Payments and Invisible Earnings, available from the Economic Research Council price 40p post free.

The Division of the National Income from Production of Goods and Services

(excluding rentier incomes)

In the constant struggle between Employers and Wage-and-Salary-earners for "fair shares" of the Gross National Income from Production of goods and services Wage-and-Salary-earners are only interested in "take-home-pay"—that is, their net earnings *after* the deduction of income tax through P.A.Y.E. and compulsory insurance contributions. Employers are primarily concerned with the Profit remaining at their disposal *after* the deduction of Corporation tax, S.E.T., and compulsory contributions to N.I. etc.

Unfortunately the whole issue is confused by taxes and insurance levies etc. imposed on both Employers and Wage-earners. Thus in the much publicised rounds of collective bargaining between Trade Unions and Employers, negotiations centre round the Gross Basic rate of pay, but this is *before* deducting P.A.Y.E. and insurance contributions and therefore is not "take-home pay".

In contrast the gross trading profits of Companies as set out in the Blue Books is the Profit left after the payment of S.E.T. and employers' contributions to N.I. but before payment of Corporation tax. For this reason the nation's total income from production as defined by the Blue Book is composed of gross wages and salaries plus gross trading profits to which has been added back employers' payments of S.E.T. and insurance levies.

In this paper we approach the problem in a new way—We investigate whether the net income (after tax) remaining at the disposal of Employers and Wage-and-Salary earners represents a fair division of the nation's "income from production" and whether the portion which is finally left in the hands of the Employers is sufficient to encourage them to expand.

According to the 1971 Blue Book, Table 20, the Total Income from Employment for the year 1970 was made up as follows:

1970	*£ million*
Wages and salaries	27,080
Pay in cash and kind of H.M. Forces	653
Employers' contributions to:	
National insurance etc.	1,355
Superannuation funds etc.	1,399
TOTAL INCOME FROM EMPLOYMENT	30,487

Since Employers' contributions to N.I. and to superannuation funds do not enter at all into the current income of Wage-earners, it is clear that this definition of "income from employment" is not a measure of the Wage-earners share of "income from production".

Fortunately we have the detailed figures with which to show how the nation's total income from the production of goods and services in 1970 was divided between Employers and Wage-earners *before* the Government took away a part of each share in Taxes; and levied insurance contributions—and we can also show the division between Employers and Wage-earners *after* the Government took away a part of each share.

1970		*£ million*
Primary income of employers:		
Gross trading profits as in 1971 Blue Book, Table 1:		
Companies	5,028	
Public corporations and other public enterprises	1,491	
	6,519	
add back		
Employers' contributions to national insurance etc.	1,355	
Selective employment tax	850	
Total primary income of employers		8,724
Primary income of employees:		
Wages and salaries	27,080	
Pay of H.M. Forces	653	
Earned from self-employment	3,345	
Total primary income of employees		31,078
TOTAL NATIONAL INCOME FROM PRODUCTION		39,802

The "Labour Market" determines the "Primary" division of the Gross Income from the production of Goods and Services (as distinct from rentier incomes) **between Employers and Wage-earners**—that is to say, the gross share of each party *before* payment of Taxes and N.I. contributions etc.

TABLE 2

NATIONAL DIRECT INCOME FROM THE DOMESTIC PRODUCTION OF GOODS AND SERVICES

Percentage shares of employers and employed before taxes and National Insurance contributions

	Total income	*Employees' share*		*Employers' share*	
		£m.	*% of total*	*£m.*	*% of total*
1949	10,484	8,186	78.1	2,298	21.9
1950	11,209	8,549	76.3	2,660	23.7
1951	12,497	9,433	75.5	3,064	24.5
1952	12,763	10,049	78.7	2,714	21.3
1953	13,513	10,574	78.2	2,939	21.8
1954	14,519	11,237	77.4	3,282	22.6
1955	15,802	12,214	77.3	3,588	22.7
1956	16,917	13,221	78.1	3,696	21.9
1957	17,749	13,917	78.4	3,832	21.6
1958	18,172	14,300	78.7	3,872	21.3
1959	19,273	14,987	77.8	4,286	22.2
1960	20,999	16,125	76.8	4,874	23.2
1961	22,222	17,341	78.0	4,881	22.0
1962	23,150	18,182	78.5	4,968	21.5
1963	24,642	19,010	77.2	5,632	22.8
1964	26,808	20,521	76.5	6,287	23.5
1965	28,743	22,067	76.8	6,676	23.2
1966	30,294	23,518	77.7	6,776	22.4
1967	31,693	24,465	77.2	7,228	22.8
1968	34,244	26,038	76.0	8,206	24.0
1969	36,399	27,923	76.7	8,476	23.3
1970	39,802	31,078	78.1	8,724	21.9

Source:

Data for years	1949-53	1954	1955	1956	1957	1958	1959	1960-70
from Blue Books	1958	1965	1966	1967	1968	1969	1970	1971

The shares for each of the years 1949/70 are shown in Table 2. Over the 22 years the mean ratio was Employers

22.5 per cent, and Wage-earners 77.5 per cent. The average deviation from the mean ratio was less than 0.8.

It is a remarkable phenomenon that the working of Britain's free labour market over more than 20 years maintained the "primary" division of income from production between the Employers and Wage-and-Salary-earners at a ratio so close to constant that it can be described as stable.

Of course the simple numeric abstraction is only the summit of a whole mountain of inter-related bargains. Most of the bargaining is done collectively by Trade Unions and is often rumbustious and a source of social friction. However it is significant that the operation of this market has little to do with the supply of labour. If it had, the present large increases in the number of unemployed would be accompanied by a fall in wages.

The strange fact is that the multitude of bargains in the Labour market over the last two decades has stabilised the "primary" division of total income from production between Employers and Wage-earners at a rate of 22.5/77.5 per cent so it is reasonable to assume that Employers have found it essential to secure their 22.5 per cent in order to remain in business. Indeed the long term stability of the ratio implies that if the Employers' share falls much below 22.5 per cent, the autonomous working of the market will move to restore the normal ratio by restricting the collective income of Wage-earners. This, of course, is only another version of the Keynesian truism that the amount Employers spend on giving employment is determined by the extent to which they judge such expenditure to be profitable.

The Theoretical Effect of Taxes on Employers' Profits

The income that finally remains at the disposal of Employers and Wage-and-Salary-earners is not determined by the working of the labour market alone. Government takes a large part of each "primary" share by way of taxes and levied contributions. But from what has been said above about the stabilising effect of the labour market on the ratio of "primary" shares it follows that if the Employers' disposable profits in aggregate are reduced by taxation to less than about 22.5 per cent of the total Income from Production, the autonomous working of the market will induce a corresponding reduction of the amount that Employers, collectively, can spend on wages and salaries. This would have the effect of restricting the total income to be shared.

Since, mathematically, income from production is a function of real output, a restriction of the one must lead to a restriction of the other. That is to say, taxation of employers' profits must have the effect of slowing down the growth-rate of industrial production. And because any reduction in the general level of wages and salaries is now out of the question, the more deeply taxation bites into profits the more Employers must reduce the number of people on their collective pay-roll.

Any taxation of Profits which derive from the production of goods and services—as distinct from rentier incomes—must therefore have the result of placing restraints on the expansion of industrial output and, if at all severe, of causing an increase in the margin of unemployment.

A slower growth-rate of real output means a slower growth-rate of the nation's real income, and hence a slower rise in the people's general standard of living. We thus arrive at the conclusion that the common social goals of political parties would be more speedily attained if these profits were relieved of taxes and levies.

The Actual Effect of Taxation on the "Primary" Shares of the Income from Production of Goods and Services

Table 1 shows that from 1964 to 1970 the Government repeatedly increased an already heavy burden of taxes and levies. In this paper we are only concerned with taxes on the Income from the Production of goods and services (income tax on wages and salaries and earnings from self-employment; levied contributions to national insurance; S.E.T.; and Corporation Tax which replaced the earlier profits tax).

The effect of these taxes on the "primary" shares of Employers and Wage-and-Salary-earners in the total Income from Production from 1950 to 1970 is detailed in Table 3 (p.13) and depicted in Chart "A" (p.14). It shows the share taken by Government; the after-tax, or disposable, Profit left in the hands of Employers; and the "take-home-pay" of Wage-and-Salary-earners.

EMPLOYERS' PROFITS

It will be seen that Employers' profits (after tax)—that is to say, their disposable profits—expressed as a percentage share of the total Income from Production did not change much between 1950 and 1966. Over those years the mean annual share was 18.7 per cent. The average deviation from the mean was only 0.6. But from 1967 onwards the Employers' share (after tax) was progressively reduced. The figure for 1970 was 12.2 per cent.

WAGE-AND-SALARY-EARNERS "TAKE-HOME-PAY"

The percentage share of the gross Income from Production which went to *Wage-and-Salary-earners in the* form of "take-home-pay" was more stable. From 1950 to 1962 there was little change. The mean annual share was 70.7 per cent. The average deviation from the mean was only 1.0. But after 1963 the Wage-and-Salary-earners' share declined. The figure for 1970 was 64.9 per cent.

TABLE 3

DIVISION OF TOTAL INCOME FROM PRODUCTION AFTER PAYMENT OF TAXES AND LEVIES: PERCENTAGE SHARES TAKEN IN TAXES AND LEVIES AND LEFT WITH EMPLOYERS AND EMPLOYED

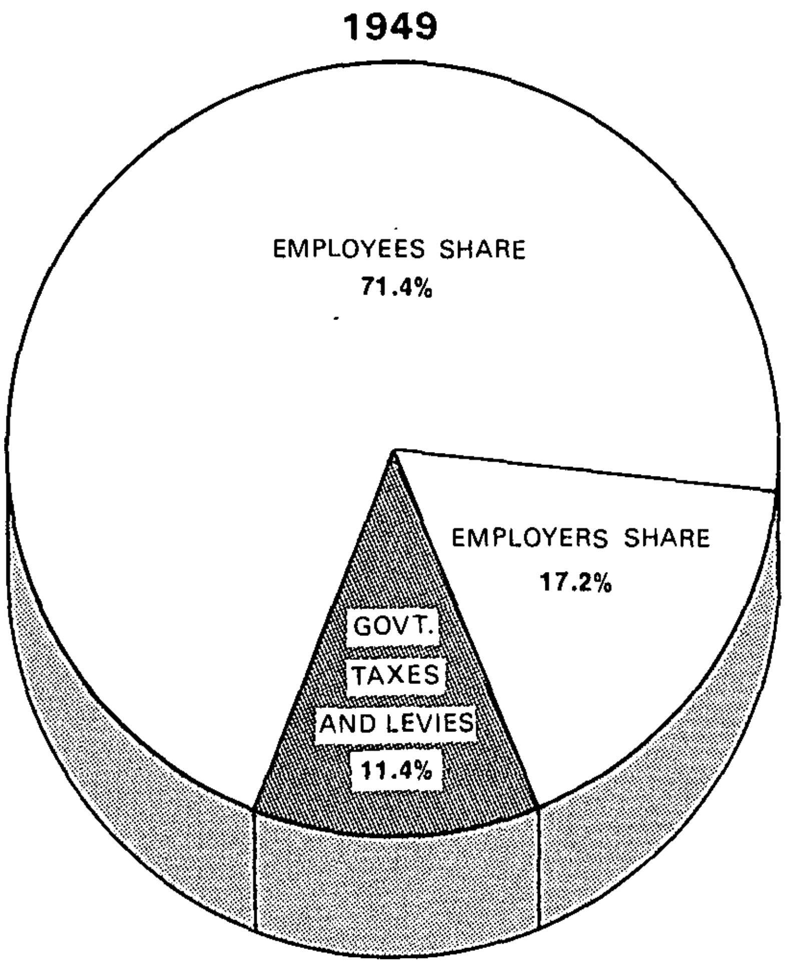
	Total income from production	*Taken by Government in taxes and levies*		*Employees' remaining share*		*Employers' remaining share*	
	£m.	*£m.*	*% of total*	*£m.*	*% of total*	*£m.*	*% of total*
1949	10,484	1,199	11.4	7,484	71.4	1,801	17.2
1950	11,209	1,189	10.6	7,836	69.9	2,184	19.5
1951	12,497	1,323	10.6	8,612	68.9	2,562	20.5
1952	12,763	1,421	11.1	9,221	72.3	2,121	16.6
1953	13,513	1,316	9.7	9,774	72.4	2,423	17.9
1954	14,519	1,353	9.3	10,384	71.5	2,782	19.2
1955	15,802	1,475	9.3	11,241	71.1	3,086	19.5
1956	16,917	1,596	9.4	12,128	71.7	3,193	18.9
1957	17,749	1,769	10.0	12,700	71.5	3,280	18.5
1958	18,172	2,069	11.4	12,908	71.0	3,195	17.6
1959	19,273	2,116	11.0	13,550	70.3	3,607	18.7
1960	20,999	2,269	10.8	14,543	69.2	4,187	19.9
1961	22,222	2,635	11.9	15,526	69.9	4,061	18.3
1962	23,150	2,957	12.8	16,161	69.8	4,032	17.4
1963	24,642	3,104	12.6	16,905	68.6	4,633	18.8
1964	26,808	3,446	12.8	18,165	67.8	5,197	19.4
1965	28,743	4,116	14.3	19,248	67.0	5,379	18.7
1966	30,294	4,559	15.0	20,284	67.0	5,451	18.0
1967	31,693	5,945	18.8	21,067	66.5	4,681	14.8
1968	34,244	6,906	20.2	22,110	64.6	5,228	15.2
1969	36,399	7,676	21.1	23,513	64.6	5,210	14.3
1970	39,802	9,103	22.9	25,828	64.9	4,871	12.2

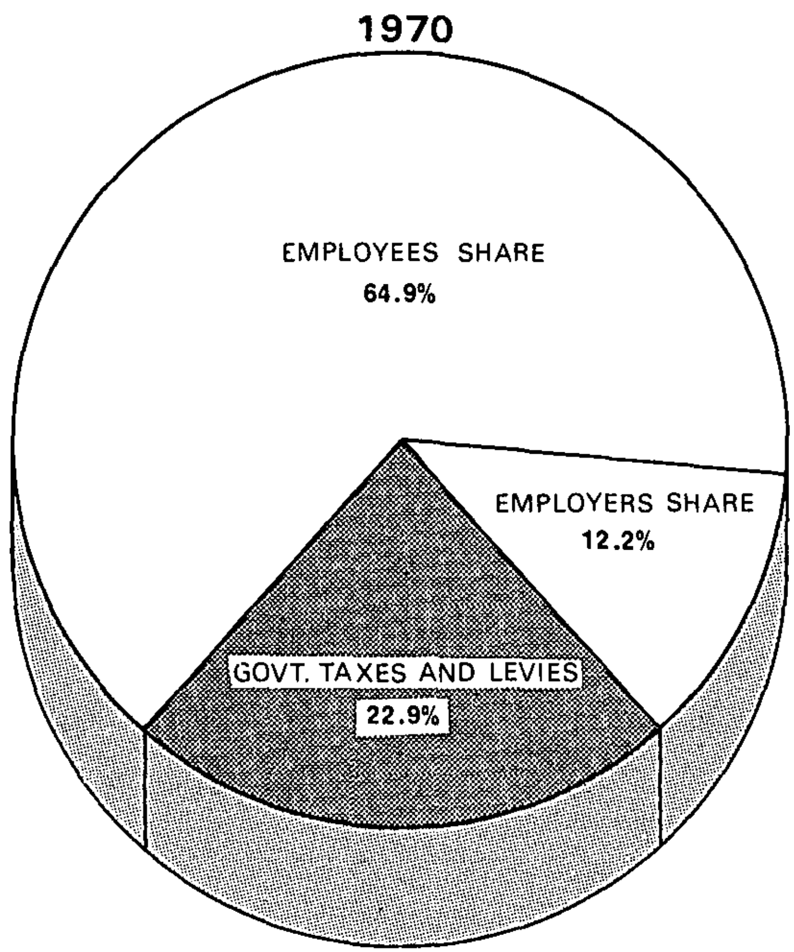
Source:

Data for years	1949-53	1954	1955	1956	1957	1958	1959	1960-70
from Blue Books	1958	1965	1966	1967	1968	1969	1970	1971

CHART "A"

HOW THE TOTAL INCOME FROM PRODUCTION WAS SHARED BETWEEN GOVERNMENT TAXES AND LEVIES, EMPLOYERS AND EMPLOYED IN 1949 and 1970.





TAXES

In contrast the share of Income from Production taken by Government in Taxes and levies for insurance followed a very different course. From 1950 to 1960 it was fairly constant. The mean annual share of Government was 10.5 per cent. The average deviation from the mean was under 0.7. From 1961 to 1964, Government's share averaged 12.5 per cent but increased sharply after 1965. The figure for 1970 was 22.9 per cent.

The general picture which emerges from this analysis of the three-way division of the Income from Production over 21 years reveals a pronounced difference between the two decades. Over the first decade the percentage shares were:

Employers 19%
Wage-and-Salary-earners 71%
Government 10%

But over the second decade there was a rapid increase in Government's share offset by reductions in the other two so that by 1970 the percentage shares had changed to:

Employers 12%
Wage-and-Salary-earners 65%
Government 23%

It should be noted that in the 1950s the after-tax shares of Employers and Wage-and-Salary-earners remained fairly stable at about 19 per cent and 71 per cent respectively, and that the ratio of these two figures is 21/79 per cent, which is close to the Labour market's normal division of the "primary" income of 22.5/77.5 per cent, which means that during that decade Taxation bit equally into both primary shares and so did not de-stabilise the market.

However, in spite of the fact that these were the years when "you never had it so good", they were also the years of disappointingly slow economic expansion and our theory suggests that this sluggish expansion resulted from the reduction of the Employers' share of the Income from Production to an average of 19 per cent which made expansion difficult.

The 1960s were traumatic years of "stop-go", the years in which Government was "managing the economy" and "defending the pound" by imposing ever-increasing taxes. As a result, by 1970 the after-tax, or disposable, profits of Employers were cut to roughly 12 per cent of the total Income from Production and we are now faced with worse stagnation coupled with high Unemployment in spite of persistent Inflation. It should be noted that by 1970 the ratio of the share of Employers and Wage-and-Salary-earners had become 12/65 which equals 15.5/84.5—a long way from the labour market "primary" division of 22.5/77.5.

Taxes and levies on Employers' profits from 1949 to 1970 are detailed in Table 4 (p.18) and the proportional effect on the Employers' share of Income from Production is shown in Table 5 (p.19). For the eleven years from 1960 to 1970 these two tables may be further condensed as follows:

EFFECTS OF TAXATION ON EMPLOYERS' PROFITS, 1960 TO 1970							
Quantitative changes in taxation of employers' profits					*Proportional effects of taxation on employers' disposable profits*		
Corporation or profits tax	*S.E.T.*	*National insurance levies*	**Total taxes and levies**		*Employers' profits* before *taxes and levies as % of total income from production*	*Taxes and levies as % of employers' profits* before *taxes and levies*	**Employers' profits** *after* **taxes and levies as % of total income from production**
£m	£m	£m	**£m**		%	%	**%**
262	—	425	**687**	1960	23.2	14.1	**19.9**
317	—	503	**820**	1961	22.0	16.8	**18.3**
379	—	557	**936**	1962	21.5	18.8	**17.4**
388	—	611	**999**	1963	22.8	17.7	**18.8**
408	—	682	**1,090**	1964	23.5	17.3	**19.4**
466	—	831	**1,297**	1965	23.2	19.4	**18.7**
120	299	906	**1,325**	1966	22.4	19.6	**18.0**
1,147	434	966	**2,547**	1967	22.8	35.2	**14.8**
1,260	619	1,099	**2,978**	1968	24.0	36.3	**15.2**
1,317	808	1,141	**3,266**	1969	23.3	38.2	**14.3**
1,644	850	1,355	**3,853**	1970	21.9	44.2	**12.2**

The table shows that there was increasingly severe taxation of Employers' profits during the 1960s. As a

TABLE 4

TAXES AND LEVIES PAID BY EMPLOYERS FROM PROFITS
£ million

	TAXES					*Levied contributions to National Insurance*	*Total taxes and levies*
	Profits tax	*Corporation tax*	*Less overspill relief*	*S.E.T.*	*Total taxes*		
1949	300	—	—	—	300	197	497
1950	277	—	—	—	277	199	476
1951	297	—	—	—	297	205	502
1952	375	—	—	—	375	218	593
1953	272	—	—	—	272	244	516
1954	253	—	—	—	253	247	500
1955	223	—	—	—	223	279	502
1956	199	—	—	—	199	304	503
1957	243	—	—	—	243	309	552
1958	279	—	—	—	279	398	677
1959	261	—	—	—	261	418	679
1960	262	—	—	—	262	425	687
1961	317	—	—	—	317	503	820
1962	379	—	—	—	379	557	936
1963	388	—	—	—	388	611	999
1964	408	—	—	—	408	682	1,090
1965	466	—	—	—	466	831	1,297
1966	135	23	-38	299	419	906	1,325
1967	39	1,166	-58	434	1,581	966	2,547
1968	12	1,285	-37	619	1,879	1,099	2,978
1969	4	1,373	-60	808	2,125	1,141	3,266
1970	2	1,677	-31	850	2,498	1,355	3,853

Source:

Data for years	1949-53	1954	1955	1956	1957	1958	1959	1960-70
from Blue Books	1958	1965	1966	1967	1968	1969	1970	1971

proportion of pre-tax profits, Taxes and levies increased *from 14.1 per cent to 44.2 per cent and Profits, after-tax,* as a proportion of total Income from Production decreased from 19.9 per cent to 12.2 per cent.

TABLE 5

PROPORTIONAL EFFECT OF TAXES AND LEVIES ON EMPLOYERS' DISPOSABLE PROFITS

	Total income from production as in Table 2	*Employers' share of total income before paying taxes and levies as in Table 2*		*Taxes and levies paid on employers' profits as in Table 4*		*Employers' share of total income after paying taxes and levies*	
	£m.	£m.	*% of total income*	£m.	*% of share before*	£m.	*% of total income taxes*
1949	10,484	2,298	21.9	497	21.6	1,801	17.2
1950	11,209	2,660	23.7	476	17.9	2,184	19.5
1951	12,497	3,064	24.5	502	16.4	2,562	20.5
1952	12,763	2,714	21.3	593	21.9	2,121	16.6
1953	13,513	2,939	21.8	516	17.6	2,423	17.9
1954	14,519	3,282	22.6	500	15.2	2,782	19.2
1955	15,802	3,588	22.7	502	14.0	3,086	19.5
1956	16,917	3,696	21.9	503	13.6	3,193	18.9
1957	17,749	3,832	21.6	552	14.4	3,280	18.5
1958	18,172	3,872	21.3	677	17.5	3,195	17.6
1959	19,273	4,286	22.2	679	15.9	3,607	18.7
1960	20,999	4,874	23.2	687	14.1	4,187	19.9
1961	22,222	4,881	22.0	820	16.8	4,061	18.3
1962	23,150	4,968	21.5	936	18.8	4,032	17.4
1963	24,642	5,632	22.8	999	17.7	4,633	18.8
1964	26,808	6,287	23.5	1,090	17.3	5,197	19.4
1965	28,743	6,676	23.2	1,297	19.4	5,379	18.7
1966	30,294	6,776	22.4	1,325	19.6	5,451	18.0
1967	31,693	7,228	22.8	2,547	35.2	4,681	14.8
1968	34,244	8,206	24.0	2,978	36.3	5,228	15.2
1969	36,399	8,476	23.3	3,266	38.2	5,210	14.3
1970	39,802	8,724	21.9	3,853	44.2	4,871	12.2

Source: see Tables 2 and 4.

The following table suggests that there is a significant *correlation between the decrease in the Employers' share of* Total Income from Production (after tax) and the increase in unemployment.

THE RELATION OF UNEMPLOYMENT TO TAXATION OF PROFITS			
	Employers' % share of total income from production after paying taxes and levies	*Percentage points by which employers' share after taxes etc. fell short of the labour market norm of 22.5%*	*Numbers on the total register of unemployed: monthly averages for the year**
1960	19.9	2.6	360,400
1961	18.3	4.2	340,700
1962	17.4	5.1	463,200
1963	18.8	3.7	573,200
1964	19.4	3.1	380,600
1965	18.7	3.8	328,800
1966	18.0	4.5	359,700
1967	14.8	7.7	559,500
1968	15.2	7.3	564,100
1969	14.3	8.2	559,300
1970	12.2	10.3	603,400

* From Department of Employment Gazette

We did not expect that the above figures would reveal a high degree of statistical correlation and in any case statistical correlation is not proof of cause and effect. Nevertheless the table does reveal that the sharp increase in Unemployment since 1966 coincided with the severe increase in Taxation of employers' profits.

In short, we contend that the statistics suggest that taxation of employers' profits contributes to the slowing down of industrial expansion and so reduces the growth of the nation's real income and, if carried too far, it may also contribute to Unemployment.

The picture we have presented is taken from official statistics but it will naturally be realised that Wage-earners come off rather better than these statistics indicate because they also receive cash payments in the form of child allowances and supplementary benefits etc. We have not been able to calculate the effect of these but if they could be taken into account we do not think they would increase very significantly the wage-earners' share of the cake and, in any case, it does not affect our main point which is the undoubted decline in Profits retained by employers.

The Inflationary effect of Wage and Tax increases on industry will be apparent. If Government now decides to take say another £2.3 million in Taxes from industry, the Wage-and-Salary earners will immediately use their bargaining power to ensure that their slice of the cake is not diminished. This means that they will demand an extra £6.5 million and the Employers, if they are to avoid having their slice of the cake reduced still further, will have to take another £1.2 million. The net result will be that the public will have to pay an extra £10 million for the same volume of goods.

Thus if Government takes £1 more in Taxes prices will rise by £4.40.

If Wage-and-Salary earners start the cycle by demanding an extra £1—the Employers and Government will fight to retain at least their present share of the cake so **prices will go up by approximately £1.55.**

However if employers wish to increase their income they can try to put up prices but in that case the Government as well as Wage-and-Salary earners will also demand an increase. So employers naturally seek to increase their profits by streamlining production and introducing labour saving machinery. **The net result will be a tendency to reduce the amount of labour employed.**

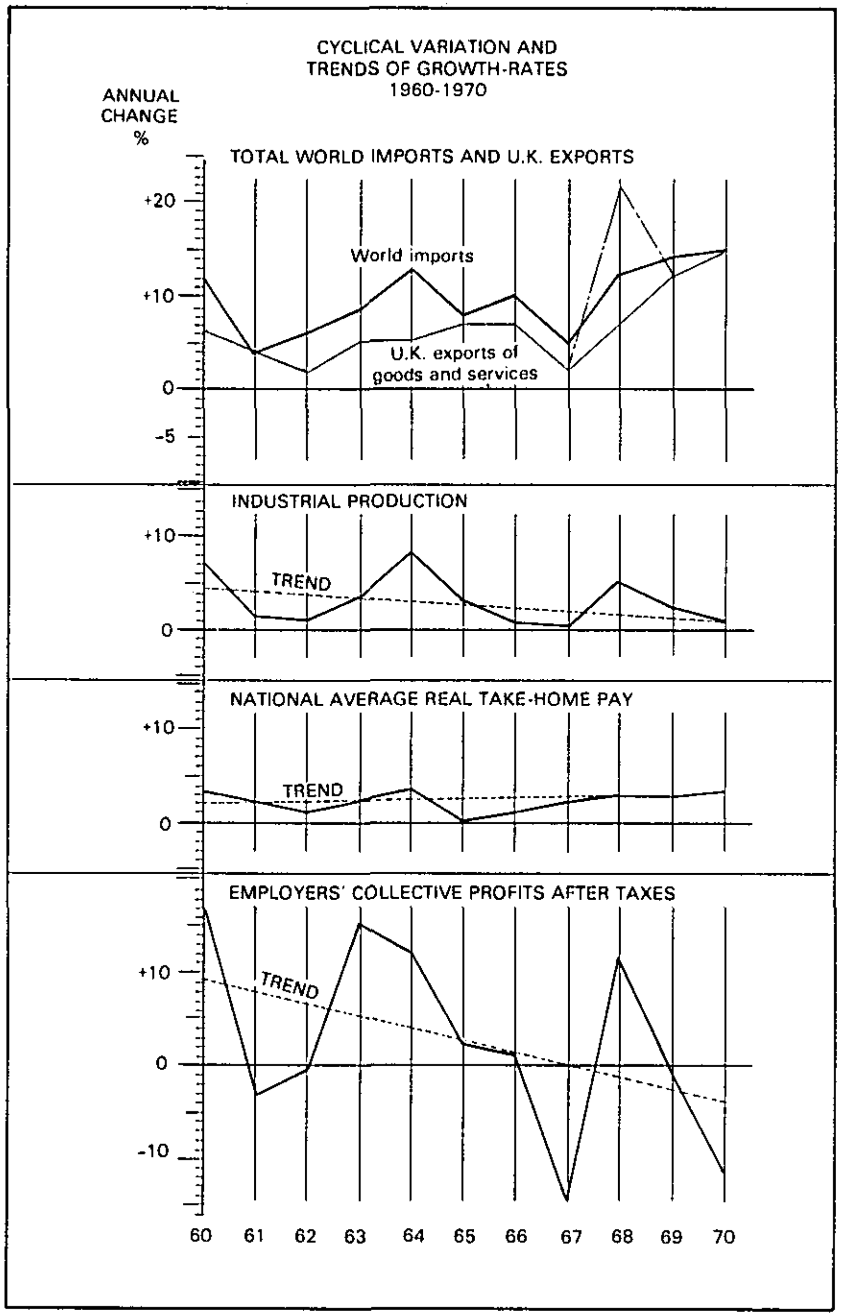
In short it is not an unreasonable generalisation to assert that every extra pound which the Government seeks to extract from industry in the form of Taxes will lead to a £4.40 increase in prices whereas every extra pound which Manufacturers seek to extract in the form of Profits will tend to reduce the number of people employed.

The variation from year to year of the growth rate of employers' profits (after tax) is calculated from data in Table 3; that of Industrial Production from the official index in the 1971 Blue Book; and that of the average real "take-home pay" (civilian employment only) by combining data from the relevant tables in the 1971 Blue Book.

The results are plotted in the lower three graphs in Chart "B" (p.22). It is immediately apparent that "taxation of employers' profits" is not the only cause of variation in these growth-rates.

As mentioned earlier in this paper the British economy

CHART B



and its banking system are deeply involved in World trade and as a result the working of the domestic economy is not, and cannot be, isolated from the powerful influences of World trade. In order to demonstrate this point graphs of total World imports and all U.K. exports have been included at the top of Chart "B" since it clearly shows that annual variation of both growth rates is influenced in some degree by the World trade cycle.

In the case of employers' profits the external influence is very strong indeed.

In order to find out whether between 1960 and 1970 there was a reduction of the growth-rates of industrial output and of average real income, it is necessary to cancel out, as it were, the effect of the trade cycle on the underlying changes in these growth-rates. This has been done in Chart "B" by plotting straight-line trends which were calculated in each case by the "method of least squares". It is apparent that there was a decline in the rate of expansion of industrial output which we attribute to a reduction of disposable Profits caused by Taxation.

The slightly rising trend of average Real Income in relation to the falling trend of Industrial Output is an anomaly which may have been caused by the distorting effect of taxation which was so heavily biased against profits.

A New Strategy

The official view: Unemployment and inflation are caused by excessive pay-increases.

The official announcement that the number of Unemployed had risen to more than a million was made on January 20, 1972. Five days later the House of Commons debated an Opposition motion to censure the Government "for the fact that their doctrinaire and irresponsible policies have forced the total of registered unemployed in the United Kingdom to 1,023,000 persons".

Speaking in the debate, the Prime Minister expressed his belief that the reflationary measures adopted in 1971 would, in due course, reduce the number of Unemployed. But a full solution to the problem depended on Investment being increased to at least the level of the European partners we were now about to join.

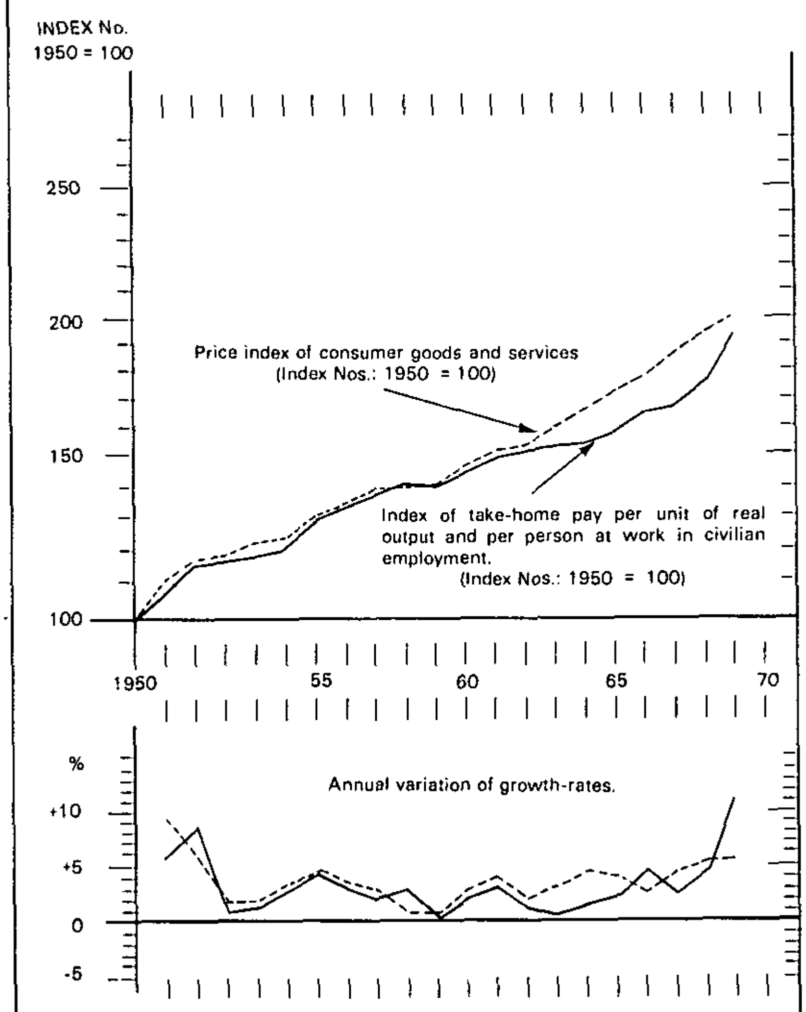
In the same debate the Chancellor of the Exchequer said that the main reason investment had lagged was the squeeze on profits caused by the excessive level of pay settlements. "Of that there can be no doubt whatever," he said. And on January 28th he expanded this theme in a speech to the Leeds Chamber of Commerce: "There can be no doubt that one of the main causes of the present tragic level of unemployment has been the excessive level of pay settlements in the past two or three years. Men have literally priced themselves out of jobs."

These official pronouncements appear to be based on the same theoretical assumptions about the cause of Inflation that appeared in the White Paper of 1956 on "The Implications of Full Employment" (Cmnd. 9725), which declared that the avoidance of Inflation was the responsibility of trades unions and businessmen who, by self-restraint in making wage-claims and in fixing prices and profit-margins, must ensure that the total money incomes rise no faster than real output. But now, not only Inflation but also the high rate of Unemployment is ascribed to a lack of self-restraint on the part of trade unions and Employers.

If these theoretical assumptions were a valid explanation of the cause of Inflation our national statistics

CHART C

The general level of prices has not been pushed up by a general increase of wages and salaries. On the contrary, across the country as a whole, the average take-home pay of employees since 1960 has risen at a rate insufficient to compensate for their increased productivity and a rising cost of living.



would show that the average "take-home pay" of all persons in employment, per unit of real output, rose over the years at near enough the same rate as the general level of Prices.

What the statistics actually reveal is set out in Chart "C" (p.25). It shows that the average "take-home-pay" of all employees since 1960 rose at a rate which lagged behind their increasing productivity (unit of real output) and the concurrent depreciation of the currency in which they were paid. Since the general level of Prices rose at a faster rate than average "take-home pay", it cannot be true that Inflation is generated by excessive pay settlements. Therefore, whilst it is right to say that Britain suffers greatly from chronic Inflation, it is wrong to ascribe the disease to wage-settlements.

As for the proposition that profits have been squeezed by the excessive pay settlements, our analysis in Table 2 has shown that all the bargaining on the labour market over recent years has had the net effect of maintaining a remarkably stable ratio of the "primary" division between Employers' Profits and Wage-and-Salary-earners' Income.

Profits have certainly been squeezed progressively since 1964, not by a disproportionate rise in average "take-home pay" but by Taxation. Between 1964 and 1970 after-tax Profits as a proportion of the total Income from Production fell sharply as a result of Taxation with the result that British companies, big and small, were deprived of the means of investment and their confidence in the future undermined.

If it were true that average wage-settlements had produced an upward pressure on the general level of Prices—i.e. had been the cause of Inflation—then we should find that Employers' costs of giving employment, per unit of real output, had risen over the years at roughly the same rate as the general level of Prices, which is the rate of Inflation.

Employers' current costs of giving employment are set out in Table 6 (p.27), and their annual rates of increase are plotted in Chart "C" which shows that since 1960 they have risen at a faster rate than Inflation.

The Prime Minister was undoubtedly right in saying that a full solution to the present problem of a million Unemployed depends on an increase of Investment, but that

because Trading Profits as a proportion of total income had fallen by a large amount between 1964 and 1970 companies in general did not have the means to invest. But the Chancellor of the Exchequer does not seem justified in ascribing both the massive Unemployment and the heavy reduction of Profits to an excessive level of pay settlements alone.

TABLE 6

TOTAL COSTS TO EMPLOYERS OF GIVING EMPLOYMENT (CIVILIAN ONLY)
£ million

	Wages and Salaries	*Employers' contributions to super-annuation funds*	*Government taxes and levies*			*Total costs to employers of giving employ-ment*
			S.E.T.	*National Insurance*	*Total*	
1949	6,600	226	—	189	189	7,015
1950	6,935	256	—	192	192	7,383
1951	7,705	288	—	196	196	8,189
1952	8,230	317	—	208	208	8,755
1953	8,700	341	—	234	234	9,275
1954	9,310	364	—	237	237	9,911
1955	10,211	398	—	268	268	10,877
1956	11,125	442	—	293	293	11,860
1957	11,765	497	—	299	299	12,561
1958	12,135	542	—	386	386	13,063
1959	12,725	575	—	406	406	13,706
1960	13,735	621	—	414	414	14,770
1961	14,855	664	—	492	492	16,011
1962	15,640	708	—	547	547	16,895
1963	16,390	770	—	601	601	17,761
1964	17,750	820	—	671	671	19,241
1965	19,085	878	—	818	818	20,781
1966	20,330	987	299	892	1,191	22,508
1967	21,120	1,076	434	952	1,386	23,582
1968	22,480	1,185	619	1,082	1,701	25,366
1969	24,215	1,283	808	1,124	1,932	27,430
1970	27,080	1,399	850	1,335	2,185	30,664

Source: see Tables 2 and 3.

Governments of both parties since 1966 have sought to control Inflation by some form of incomes policy, whether by calling for a six-month standstill of wages and salaries, followed by a further six months of severe restraint, or by imposing ceilings on pay negotiations in the public corporations and nationalised industries. This attitude accounts for the present Government's determined resistance to "excessive wage-claims" when faced with a national strike by coal miners who were equally determined to obtain an increase in average "take-home pay" which would compensate them for their increased productivity and the depreciation of the currency in which they were paid.

We need a new Economic Strategy

A new economic strategy is required to replace the Basic Policy outlined in the White Paper of 1956 on The Implications of Full Employment (Cmnd. 9725). That Policy was based on theoretical assumptions which we regard as obsolete. We know that our present economic disorders developed during the period of "stop-go" which followed on the adoption of that Basic Policy.

We must here make it plain that we do not assert that wage increases have not affected prices—of course they have. We merely contend that Wage-and-Salary-earners naturally seek to retain their share of the Cake of Income from Production. So if the Government takes an extra piece of Cake, Wage-and-Salary-earners will fight to ensure that it is not at their expense. Therefore the net effect of adding to the taxes on industry is to encourage additional wage demands and the additional taxes and wages will, in the end, be passed on to the consumer in the form of rising prices.

Statistics make it plain that it is the Employers who have suffered in the conflict. Their share of the Cake has been reduced and so it is not surprising that the country is suffering from Stagnation.

What we have shown in this paper is that the increasing Taxation of Employers' profits imposed in accordance with the Basic Policy has undermined confidence and slowed down the growth of industry and finally appears to have contributed to the growth of Unemployment.

The need for a new strategy is concisely summed up in the following passage:

". . . we have learned the hard way that deflation and contraction, so far from making us more efficient and competitive, have the opposite effect—costs rise, essential investment is discouraged, restrictive attitudes on both sides of industry are encouraged; a policy which relates incomes to expanding production is made infinitely harder to achieve".

That was the opinion expressed by Mr. Harold Wilson in his first policy speech as Prime Minister, in the House of

Commons on November 3, 1964. (Hansard, col. 79). The record suggests that his initial judgement was over-ridden by the orthodox theories of demand-management of his advisers which led him to impose ever increasing restrictions on the economy. We hope that those theories will soon be regarded as obsolete.

The Feasibility of Relieving Employers' Profits from Taxation

The Government and Public Authorities spend money each year on both Current and Capital account. Both are now financed out of Current Taxation—but there is no reason why public Capital expenditure should be financed out of Taxation.

TABLE 7

PUBLIC SECTOR FINANCES
Receipts
£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Taxes and other levies:							
Taxes on income	3,522	4,021	4,419	5,083	5,631	6,321	7,429
Taxes on expenditure (inc. S.E.T.)...........	3,362	3,758	4,237	4,529	5,391	6,194	6,636
Nat. Insurance levies	1,444	1,685	1,804	1,909	2,165	2,244	2,655
Local authority rates	1,096	1,228	1,374	1,467	1,548	1,666	1,822
Taxes on capital...........	308	290	315	339	439	637	659
TOTAL taxes and levies	9,732	10,982	12,149	13,327	15,174	17,062	19,201
Gross trading surpluses:							
Central Government and local authorities....	91	96	87	88	108	114	112
Public corporations......	924	988	1,042	1,132	1,363	1,452	1,379
TOTAL trading surpluses	1,015	1,084	1,129	1,220	1,471	1,566	1,491
Rent.................................	603	676	750	816	916	1,052	1,192
Interest and dividends etc................................	192	233	256	268	279	301	299
Net receipts from other transactions, including import deposits............	228	-23	66	65	-30	264	-615
TOTAL RECEIPTS.........	11,770	12,952	14,350	15,696	17,810	20,245	21,568

Source: 1971 Blue Book, Table 49.

Before the Great Depression, and the Keynesian revolution which *introduced the idea that the national* economy can and should be managed by Government, the sole purpose of Taxation was to finance the Current expenditure of the State. Taxation and Expenditure were under the sovereign control of Parliament.

TABLE 8

PUBLIC SECTOR FINANCES
Expenditure
£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Current account:							
Current expenditure on goods and services	5,516	6,047	6,577	7,282	7,739	8,130	9,055
Subsidies	509	564	560	801	893	841	848
Current grants to persons	2,257	2,604	2,834	3,199	3,689	3,944	4,321
Current grants abroad	163	177	180	188	179	177	172
Debt interest	1,354	1,456	1,553	1,711	1,913	2,036	2,105
TOTAL current expenditure	9,799	10,848	11,704	13,181	14,413	15,128	16,501
Capital account:							
Gross domestic fixed capital formation	2,580	2,776	3,131	3,619	3,790	3,694	4,004
Increase in value of stocks	29	28	66	109	58	19	99
Capital grants to private sector	148	180	187	412	655	795	747
Net lending to private sector	130	225	83	111	86	35	99
Net lending to overseas Governments	65	50	64	61	60	52	83
Other capital expenditure (net)	14	33	74	32	62	46	31
TOTAL capital expenditure	2,966	3,292	3,605	4,344	4,711	4,641	5,063
TOTAL EXPENDITURE	12,765	14,140	15,309	17,525	19,124	19,769	21,564

Source: 1971 Blue Book, Table 50.

In those days the management of our public finances was governed by the rule that Current Expenditure must be covered by Current Revenue from Taxation and that Capital expenditure must be financed by long-term Borrowing on the specific authority of Parliament.

On the outbreak of war in 1939 the fiscal sovereignty of Parliament was ceded to the Treasury, where it still remains. The statutory rule which forbade deficit spending was repealed by the National Loans Act of 1968, which not only permits Capital expenditure to be financed out of current revenue but also authorises the Treasury, whenever public expenditure exceeds current income, to cover the deficit by raising money "in such manner and on such terms and conditions as the Treasury think fit".

The public Income for the years 1964 to 1970 is detailed in Table 7 (p.31), and Expenditure in those years on Current and Capital account is detailed in Table 8 (p.32). The annual balances between them are summarised in the following table:

PUBLIC SECTOR FINANCES: BALANCE OF RECEIPTS AND EXPENDITURE, 1964-1970

£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Total receipts	11,770	12,952	14,350	15,696	17,810	20,245	21,568
Less: *Current expenditure*	9,799	10,848	11,704	13,181	14,413	15,128	16,501
Equals surplus of total receipts over *Current expenditure*	1,971	2,104	2,646	2,515	3,397	5,117	5,067
Less: *Capital expenditure*	2,966	3,292	3,605	4,344	4,711	4,641	5,063
Equals public sector "borrowing requirement", or deficit (–) from excess of *Total expenditure* over Total receipts	–995	–1,188	–959	–1,829	–1,314	+476	+4

It is clear from the above summary that if Capital expenditure had not been financed out of Current revenue taxation would each year have produced a substantial surplus. In short, if we now return to the rule that public Capital expenditure must be financed by long term Borrowing, Taxes could be substantially reduced.

The present practice of providing Capital out of Current revenue was adopted in 1956 at a time when the Government had great difficulty in borrowing at long term. The nationalisation of major industries immediately after the war had placed an excessive load on the gilt-edged market, which already had a heavy backlog of maturities to finance. But that situation no longer obtains. Moreover, the public sector's "borrowing requirement" was financed by the Treasury in such a way that liquid funds at the immediate disposal of the Private sector increased from £17,032 million at December 31, 1962, to £31,412 million at September 30, 1971* which we regard as the basic cause of Inflation.

There can be no doubt that if the Treasury offered sufficiently attractive terms and conditions it would now be possible to raise the Capital required by the public sector by long-term Borrowing.

Of course some forms of public Capital expenditure do not add to the capital assets of the nation—e.g. capital grants to private industries and writing off the accumulated debts of nationalised industries—and even where Capital expenditure results in fixed capital formation a distinction should be drawn between such things as schools and hospitals which are non-trading and housing, power stations, or the post office which are income earning.

As a first step we suggest relieving the taxpayer from the burden of financing the Capital requirements of public corporations and nationalised industries, and of local authorities in respect of housing. These are all income earning businesses which, given sound management, should be able to raise the long term capital they need from the market.

Total expenditure on fixed capital formation in 1964/70 is detailed with other capital expenditure in Table 8. It is

*From "Financial Statistics", January, 1972. Table 84.

further analysed in Tables 9 and 10 (pp. 35 & 36) into expenditure on income-earning services and non-trading services.

These figures show that Capital expenditure on income-earning services has recently been running at about £2,500 million a year. If this were financed by long term Borrowing it would be possible to reduce Taxes by a like amount.

The present burden of taxes and levies on industry is running at £4,000 million a year. If it could be reduced by £2,500 million we believe it would instantly revive confidence and encourage industry to expand with such vigour that much of our unemployment problem would quickly vanish.

TABLE 9

PUBLIC SECTOR FINANCES
Capital expenditure on fixed capital formation
for INCOME-EARNING services
£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Pulbic corporations:							
Transport and communications	337	379	384	470	568	534	650
Other industries and trade	796	854	1,001	1,106	959	845	857
Housing	44	49	56	65	70	81	80
Other services	7	7	7	10	14	14	12
TOTAL public corporations	1,184	1,289	1,448	1,651	1,611	1,474	1,599
Local authorities, housing	495	545	655	743	787	777	735
Central government and local authorities:							
Transport and communications	33	38	50	50	55	47	67
Other industry and trade	28	34	36	41	42	54	59
TOTAL, INCOME-EARNING SERVICES	1,740	1,906	2,189	2,485	2,495	2,352	2,460

Source: 1971 Blue Book, Table 50.

TABLE 10

PUBLIC SECTOR FINANCES
Capital expenditure on fixed capital formation for NON-TRADING services

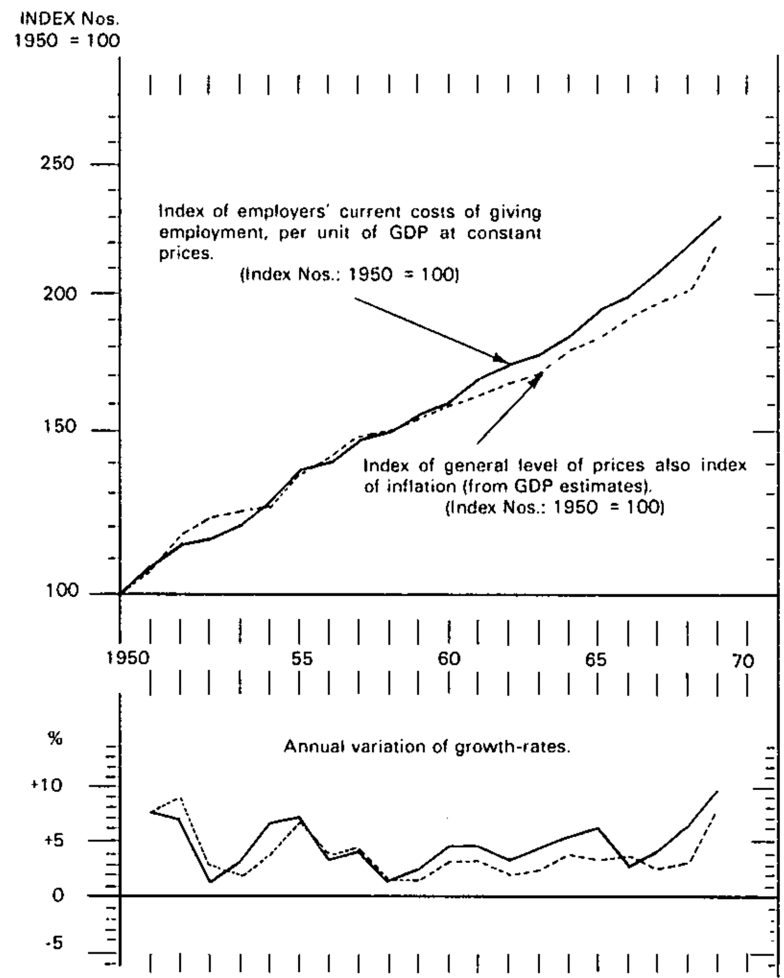
£ million

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*
Social services:							
Education	180	171	185	234	262	265	288
National health services	76	91	102	125	143	143	157
Public health services	3	2	2	5	3	5	6
Local welfare services	13	15	15	17	19	18	18
Child care	2	3	3	4	5	4	5
Research	21	19	20	19	25	24	28
Libraries, museums and arts	5	5	5	6	7	7	8
TOTAL social services	300	306	332	410	464	466	510
Infrastructure and environment:							
Services to agriculture, forestry, fishing and food	4	5	5	5	6	6	7
Roads and public lighting	214	219	236	300	353	418	513
Water, sewage and refuse disposal	126	127	146	170	199	210	238
Land drainage and coast protection	9	9	10	11	13	13	15
Parks, pleasure grounds etc.	18	20	17	12	18	20	24
TOTAL, infrastructure	371	380	414	498	589	667	797
Security services:							
Defence, military and civil	28	22	32	43	46	19	25
Fire service	6	6	6	7	9	8	9
Police	16	19	21	24	24	24	26
Prisons	6	5	5	5	9	11	10
TOTAL, security services	56	52	64	79	88	62	70
Other services:							
Central government	36	41	43	48	51	49	57
Local authorities	77	91	89	99	103	98	110
TOTAL, other services	113	132	132	147	154	147	167
TOTAL, NON-TRADING SERVICES	840	870	942	1,134	1,295	1,342	1,544

Source: 1971 Blue Book, Table 50.

CHART D

The notion that Britain suffers from chronic cost-push inflation is not supported by the empirical evidence. In fact, employers' cost of giving employment, per unit of real output, have risen faster than the general level of current prices at which the total output was sold, i.e., at above the rate of inflation.



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