A Programme for NATIONAL RECOVERY

TAXATION: THE FINANCING OF PUBLIC EXPENDITURE

Research Paper No. 4

The original programme was signed by the following:

Lord Aberdare
Lord Barnby
Sir Arthur Bryant
Professor Colin Clark
Sir Roy Dobson
A. Frood
Professor Dennis Gabor
*Edward Holloway**
Graham Hutton
*Patrick de Laszlo**
W. E. Luke
*W. A. P. Manser**
Professor C. Northcote Parkinson
*Dr. John Paxton**
Sir Halford Reddish
Sir John Reiss
Hubert Starley
Sir Iain Stewart
Antony Vickers

• *Members of the Research Committee responsible for this publication.*

PRICE 7s. 6d. (*post free*)

A Programme for NATIONAL RECOVERY

TAXATION: THE FINANCING OF PUBLIC EXPENDITURE

CONTENTS

NATIONAL RECOVERY PROGRAMME

REPORTS PUBLISHED

No. 1. INFLATION *(out of print).*

No. 2. EXPANSION WITHOUT INFLATION, 7/6 *(post free).*

No. 3. BALANCE OF PAYMENTS AND INVISIBLE EARNINGS, 7/6 *(post free).*

No. 4. TAXATION: THE FINANCING OF PUBLIC EXPENDITURE, 7/6 *(post free).*

No. 5. RESOURCES *(to be published shortly).*

Obtainable from:

National Recovery Programme
10 Upper Berkeley Street
London, W.1

A Programme of NATIONAL RECOVERY

FOREWORD

This Paper argues that taxation not only should, but could, be substantially reduced. In July, 1967, when we introduced "A Programme for National Recovery", we declared our intention to produce a series putting forward positive proposals for economic recovery; and among the topics to be studied we attached particular importance to a "modern and equitable tax system".

In this fourth Study we originally intended to make proposals for the reorganisation of the tax system but methods of improving the system have long been the subject of study by expert groups, several of whom have published reports since 1967. We would mention in particular "Taxation" (Study No. 3), published by the Industrial Policy Group in January, 1969, and "Taxation Economics"*, published by Macmillan in October, 1969, which contains contributions by eminent authorities who participated in a series of Study Lectures arranged by the Economic Research Council.

Our fourth Study, therefore, makes proposals for reducing the total volume of taxation rather than for reorganising the structure of the system. We believe that this attempt to consider another aspect of the taxation problem will prove to be timely. At the Conservative Party Conference this year, Mr. Iain Macleod declared that "our first priority is the reduction of the burden, both of taxation and public expenditure".

The research and formulation of the general theme of this Study is once again the work of Mr. F. W. Tooby, to whom we are greatly indebted. The members of the Committee

---

* ***Taxation Economics,*** **edited by Martin Cadman. Macmillan 45/–**

responsible for the programme of research are Patrick de Laszlo, W. A. P. Manser, John Paxton, and the undersigned.

Our fifth and final study on the full use of our resources is now well advanced. It will point to the concealed under-use of our resources and will show that the economy could grow rapidly as soon as these resources are released by the introduction of wiser economic policies.

NOVEMBER, 1969 Edward Holloway.

Summary

For nearly a century, up to 1914, this country's public finances were managed according to simple but effective rules. All public expenditure on capital account was financed by genuine borrowing and appeared as formal additions to the National Debt which were specifically authorised by Parliament, and not out of current revenues from taxation. On current account the rule was that the budget should balance; deficit spending, i.e. spending in excess of taxation was not allowed, and tax revenues could be no higher than was necessary to cover authorised spending on current account.

The exigencies of financing two world wars forced the managers of our public finances to depart from those rules. In war, public spending on current and capital account far exceeds what can be taken from the private sector's income by taxation and borrowing and the rest of the necessary deficit spending has to be financed by inflation by the simple creation of money.

Inflationary deficit financing is justified when a country is engaged in a war that involves its total resources, or to fend off a major economic depression but there is no justification for deficit spending in peacetime, except when there are clear signs of under-use of resources. Yet, from 1946 to 1968 public spending exceeded public revenues, in spite of the steep rise in taxation. Since 1964, large deficit spending has been financed almost entirely by the inflationary creation of money.

The first main point made in this paper is that a return to the pre-war principles of financial management is an essential first step to restore stability to the currency and the economy. Then, when the capital requirements of the public sector are again provided out of authorised borrowing and not out of current tax revenues it will be possible to reduce the level of taxation to what is necessary to cover only the approved public spending on current account.

The second main point is that in post-war Britain, tax revenues are not the only source of public sector income. The main components of the public sector's income other than from taxation including rates are rents from local authority housing and the gross trading surpluses of the public corporations. An increase of this other income would serve to lower the level of taxation necessary to balance the budget on current account.

This reason for increasing the public sector's other income is reinforced by another. If we are to return to the principle that the public sector's capital requirements are to be met by formal borrowing from the private sector it is essential that the private sector's monetary saving shall be large enough to cover it; but in recent years this has not been the case. Though it may be possible to increase savings in the private sector through reduction in taxation, it is nevertheless essential that earnings of those undertakings of the public sector which are revenue-producing be increased. This increase must be enough to make the undertakings as self-sufficient in the provision of capital by plough-back as are the industrial and commercial companies in the private sector.

At the present time, the financial situation of local authority housing in the aggregate is that the rents received do not even cover the related current outgoings: this deficit is growing, and amounted to £214 million in 1968. On top of this, the total cost of building additional dwellings has more than tripled in the last ten years and amounted to £785 million in 1968. In total, therefore, the net cost out of current income to the taxpayers at large to provide local authority housing for only a part of the population is now £1,000 million a year, and is rapidly rising.

The paper recognises, however, that political considerations would rule out any general raising of rents on the scale that would be necessary to rectify the gross insolvency of local authority housing. Nevertheless, the problem should be tackled selectively, and the paper suggests that its solution could be eased by vigorously encouraging the sale of dwellings to sitting tenants on the lines of hire purchase and on terms approximating to those for private house purchase through a building society mortgage.

The public corporations, on the other hand, must be directed immediately to be more efficient and to increase

their return on the public capital employed, so that they not only cover interest charges but also provide a net trading surplus sufficient to meet by plough-back the major part, if not all, of their fixed capital requirement.

Conclusion

From this brief review of public sector finances we conclude that taxation could and should be reduced. To achieve this, the managers of our public finances should return to the rule that all public spending on capital account must be financed by systematic borrowing from the non-bank private sector, and there must be no deficit spending on current account.

The aim should be to maintain an even balance between the requirements of investment capital of both public and private sectors on the one hand and current saving by the private sector on the other. The charges made by public corporations and nationalised industries should be increased so that their capital needs are met out of their trading surpluses at least to the extent required to equate their borrowing requirement with the availability of private savings.

Rent charged for Local Authority housing should be steadily increased until it begins to yield some real return on the capital employed.

If these steps were taken the national economy and our monetary system would be restored to equilibrium and thus create the condition essential for real economic growth.

Introduction

Current ideas about how the national economy should be managed are still relatively new. They stem from the publication in 1936 of the General Theory by J. M. Keynes.

Before that the management of our national finances was governed for a century or more by the orthodox theories of the City of London.

The basic principle of this orthodox thinking, which had a very long history, was that taxes should only be levied to defray the necessary expenses of Government. Indeed, for nearly 700 years Parliament fought to secure control over expenditure and the exclusive right to levy taxes so as to protect the people from despotic taxation. In the end Parliament established its right to discuss the details of each annual budget with the object of securing that expenditure would be reasonable and that the revenue raised by taxation should be sufficient, but not more than sufficient, to cover approved expenditure—in brief, that budgets should be balanced.

Since Keynes introduced his new ideas, they have been seized upon by politicians and distorted to justify policies which would never have been approved by Lord Keynes. The principal result has been that Parliament has ceased to exercise effective control over either expenditure or taxes, and the public has been cajoled into believing that it is unnecessary for budgets to balance. Taxes are no longer regarded simply as a means of meeting essential expenditure. They are now used to take money away from one portion of the community in order to give it to another portion of the community on ideological grounds and also as a lever by which the Government attempts to control the economic climate of the country for its own convenience.

Though politicians still pay lip service to the idea that the primary object of taxation is to meet public expenditure there has, in fact, since the 1939/45 war, been little relation between taxation and expenditure. A new kind of "Parkinson's law" has taken control with the result that no matter how much taxation has been increased, public spending has always exceeded it.

Parliament has completely lost control over Government expenditure and taxation. Plans for expenditure and taxation are announced in the Commons each year by the Chancellor of the Exchequer as part of a ritual Budget speech on a motion which is treated as a motion of confidence with the result that there is no effective discussion. Many Members of Parliament never have the time even to understand the implications of new taxes which are proposed.

Under the system of P.A.Y.E., which came into force in 1944, a large majority of the working population have come primarily to concentrate on their "take home pay", regarding the amount of taxes and contributions that are deducted as mysteries they cannot fathom, merely being conscious that the State is making larger and larger demands on their rewards for extra effort. So the British people are now subject to taxation virtually by decree (which is "taxation without representation"), but the majority seem resigned to this evidence of decay in their hard-won democracy.

During the century which preceded the 1914 war—in the days when Britain was rich and powerful and Sterling was the strongest currency in the world—Parliament jealously guarded its rights to control public spending and to control the method of raising money to meet it.

The management of our national finances in those days was governed by a set of rules which was simple and effective. The two main rules were codified in the Sinking Fund Act of 1875. It required that any deficit "above the line" (on current account) in any year which had to be met by borrowing —and, therefore, increased the national debt for that year— must be made good by redeeming the additional national debt out of extra revenue raised during the following year. Any surplus "above the line" (on current account) in any year must be used for debt redemption during the following year. This rule gave a sensible leeway for temporary deviations in "above the line" (current account) expenditure but firmly insisted that in the long run budgets must balance.

There was no equivalent statutory rule about "below the line" (or capital) expenditure, which was mainly comprised of Central Government contributions to the capital expenditure of Local Authorities and Public Corporations, but it was a firmly established custom that "below the line" (or capital) expenditure must not be met out of current revenue but out of money borrowed for a particular purpose and specifically authorised by Parliament. Indeed, Parliament insisted on laying down the precise method of borrowing on each occasion.

In brief, the years of our greatest economic strength were dominated by the basic rules that "above the line" or current account expenditure must be covered by revenue from taxation which means that budgets must balance and that "below the line" or capital expenditure must only be financed by borrowing authorised by Parliament.

The statutory rule which forbade deficit spending under the Sinking Fund Act of 1875 was repealed by the National Loans Act of 1968 which not only permits capital expenditure to be financed out of current revenue but goes on to authorise the Treasury, whenever public spending exceeds public income, to cover the deficit by raising money "in such manner and on such terms and conditions as the Treasury think fit".

AMENDMENT REJECTED

During the debate at the report stage of the National Loans Bill, in February 1968, the Opposition attempted to restrict the absolute discretion which was to be ceded to the Treasury. Unfortunately, the Opposition was over-ruled. The Chief Secretary for the Treasury, Mr. John Diamond, said: "I am resting myself quite simply on the proposition that these words and these powers were thought right in 1919 when they were first introduced. They were confirmed in the National Loans Act, 1939. They have been there ever since. They have been found right and we propose to continue them. I reject the Amendment." (Hansard, Vol. 759, col. 179).

The Treasury's claim to absolute discretion in managing the public purse dubiously rests on the proposition that during two world wars circumstances made it necessary for Parliament to abandon control and allow the Treasury to raise money for emergency spending by any possible means irrespective of the long-term consequences. Since it was impossible in war time to distinguish between capital and current expenditure and since it was inevitable that war-time spending would far exceed anything which could be raised by taxation or formal borrowing it was equally inevitable that the deficit would have to be financed by creating new money.

During the two wars, when the life of the country was at stake, Parliament was obviously justified in ceding absolute discretion to the Treasury—even though it was realised, by those who understood such matters, that the result would be gross inflation.

EFFECTIVE CONTROL

However, emergency measures which may be necessary in time of war should not continue in time of peace. Simple logic suggests that since the Treasury had become accustomed to meeting expenditure by inflation it would be wise for Parliament to take back its powers as soon as possible and again exercise effective control. Instead, with the passing of the National Loans Act of 1968, the House of Commons confirmed the transfer of an important part of its sovereignty to the Treasury. Parliament abandoned the main object for which it had struggled for over 7C0 years and the word democracy in this country lost much of its meaning.

As a result of Parliament ceding its powers to the Treasury in peace-time many of the sound principles by which public expenditure used formerly to be controlled were jettisoned. Every year from 1946 to 1968 public expenditure has exceeded public revenue—largely because the Government has attempted to meet the greater part of its increasing capital expenditure out of current revenue. The balance of expenditure which it has been unable to cover in this way is, of course, the Public Sector's deficit and is described as "the borrowing requirement". As public spending has increased, the Private Sector—in other words, the private citizen—has become ever more reluctant to lend money to the Government and so the "borrowing requirement" has been financed almost entirely out of the inflationary creation of new money, as shown in our Research Papers 1, 2 and 3. In brief, the growing inflation from which we have been suffering has been the direct result of Treasury management of the economy without effective control by Parliament.

In spite of persistent deficit spending with its inflationary consequences the old folk-lore idea still persists that the total of public spending is covered by the proceeds of taxation and so political leaders, who bid for votes by promising lower taxes, are immediately challenged by their opponents to declare where they will cut down public spending so as to make their promises credible.

These disputes are completely unrealistic. They overlook the fact that for many years the revenue from taxation has been more than was necessary to meet current expenditure—there has been a handsome surplus on current account.

The Public Sector's deficit has been due to the fact that the Government has been supplying ever increasing sums to Local Authorities and Nationalised Industries to meet their capital expenditure. Instead of raising this money by internal borrowing, which would not have been inflationary, it has, to a large extent, been found from external borrowing which is inflationary.

The Financial Secretary to the Treasury, Mr. Harold Lever, speaking to the London Press Club in June 1969 said "our present financial difficulties are rooted in the past". He would have been nearer the truth if he had said that our present financial difficulties have only grown up during the post-war period because Parliament permitted the Treasury to continue in peace-time the inflationary devices for raising money which were necessary during the desperate war years.

It is our view that a return to well-tried principles is an essential first step towards restoring the stability of our currency and our economy. Once that is accomplished, taxation could and should be reduced.

CHAPTER I

Taxation could be reduced if . . . . . .

(Note on the tables: In order to avoid overburdening the reader with massed columns of numerical data, full summaries of public sector income and expenditure are placed in the Appendix and lettered A and B. To illustrate the argument, selected columns from these comprehensive summaries are juxtaposed in the text as simple tables, which are numbered.)

We start by establishing the fact that the Public Sector's total spending has for many years exceeded its total income. The bare details for the ten years 1959–68 are shown in Table 1, from which it is clear that the managers of our economy, who are responsible also for managing our public finances, no longer observe the Victorian rule of a balanced budget. Deficit spending has become normal. In the private sector of the economy the limitations of income place restraints on expenditure. There is no such restraint on the public sector's spending, because any deficit is always covered by automatic borrowing, and because the borrowing can be—indeed, since 1964 it has been very largely—in the form of simply creating money.

TABLE 1
BALANCE OF TOTAL INCOME AND EXPENDITURE OF THE PUBLIC SECTOR 1959 TO 1968
£ million

	Total income detail in Table A	Total expendi-ture detail in Table B	Deficit or borrowing require-ment
	(1)	(2)	(1–2)
1959	8,247	8,810	— 563
60	8,711	9,425	— 714
61	9,591	10,304	— 713
62	10,483	10,999	— 516
63	10,829	11,687	— 858
64	11,695	12,748	— 1,053
65	13,017	14,201	— 1,184
66	14,360	15,352	— 992
67	15,677	17,573	— 1,896
68	18,032	19,172	— 1,140

When total public spending is divided between current account and capital account, as shown in Table 2, it is seen that the managers have also abandoned the rule that all expenditure on capital account (or below the line) should be financed out of authorised borrowing, and not out of current income.

Table 2 also shows that the Public Sector during the period has a surplus of income over current expenditure which rose from £1,168 million in 1959 to £3,633 million in 1968. These surpluses on current account were in fact all used to finance capital expenditure. But if, in the post-war years, Parliament had insisted on a return to the rule that capital expenditure must not be financed out of current revenues, then taxation could have been reduced because the income from taxation was far greater than was necessary to meet current expenditure.

TABLE 2

CURRENT ACCOUNT SURPLUS AND CAPITAL ACCOUNT DEFICIT, 1959 TO 1968

£ million

	Total income detail in Table A	Expenditure detail in Table B			Surplus on current account	Deficit on capital account
		Current account	Capital account	Total		
	1	2	3	4 (2+3)	5 (1−2)	6 (5−3)
1959	8,247	7,079	1,731	8,810	1,168	563
60	8,711	7,577	1,848	9,425	1,134	714
61	9,591	8,275	2,029	10,304	1,316	713
62	10,483	8,814	2,185	10,999	1,669	516
63	10,829	9,303	2,348	11,687	1,526	858
64	11,695	9,807	2,941	12,748	1,888	1,053
65	13,017	10,856	3,345	14,201	2,161	1,184
66	14,360	11,715	3,637	15,352	2,645	992
67	15,677	13,153	4,420	17,573	2,524	1,896
68	18,032	14,399	4,773	19,172	3,633	1,140

It is apparent that a return to the old-fashioned rules for managing the public finances would open the way to a substantial reduction of taxes, but it should also be noted that the Public Sector's total income includes revenues other than

taxation. The details for the years 1959–68 are shown in Table 3.

The main components are rents for Local Authority housing and the gross trading profits of the Public Corporations and nationalised industries. These sources of income belong to the post-war period; they played no part in balancing the budget under the old regime. But now they contribute substantially to Public Sector resources. However, their contribution is not as large as it should be. The return on the vast sums of public money which have been invested in local authority housing and in the nationalised industries since 1946 is inadequate.

TABLE 3

TAXATION AND OTHER INCOME OF THE PUBLIC SECTOR 1959 TO 1968

£ million

	Income of the public sector details in Table A		
	Total	Revenues from taxation	Other income
1959	8,247	7,056	1,191
60	8,711	7,253	1,458
61	9,591	8,040	1,551
62	10,483	8,806	1,677
63	10,829	9,039	1,790
64	11,695	9,753	1,942
65	13,017	10,989	2,028
66	14,360	12,129	2,231
67	15,677	13,335	2,342
68	18,032	15,229	2,803

CHAPTER II

Raising capital for the public sector

There are naturally good reasons why we have not returned to the pre-war practice of raising all the capital required by the Public Sector entirely by formal borrowing from the British public. Firstly, since 1939, inflation has steadily eroded the value of the pound, with the result that uncertainty about the future real value of fixed-interest securities has wrecked the gilt-edged market. Secondly, structural inadequacies of the international monetary system (created at Bretton Woods in 1944) have produced a great international market in dollar balances, and the high rates of interest which they attract influences interest rates in Britain. Until very recently the authorities regarded the latter development as a temporary phenomenon, and were consequently reluctant to raise capital by issuing long-term securities at the current high rates of interest.

Of these two obstacles in the way of our return to financial rectitude, the second could be removed by administrative decision within the Government. In contrast the damage done to the economy by the breakdown of the gilt-edged market is much more difficult to remedy, since what has to be restored is confidence in the pound both at home and overseas.

It is very obvious that public confidence in the future of the pound will not return until the Government is seen by the public to have mastered the causes of inflation and so put an end to the continuous fall in the purchasing power of money. Happily, there are encouraging signs of growing understanding that the prime cause of inflation in the post-war period has been the same as it was during the 1939/45 war. More and more people now recognise that the cause of the inflation which has persisted since 1939 is that Public Sector spending has always exceeded what has been taken from Private Sector resources by taxation and genuine borrowing, and that the deficit has been financed in very large part by the creation of money by unrestrained additions to the Government's floating debt.

This being so, it might seem that we should rejoice in

the announcement by the Chancellor of the Exchequer that he expects the financial year 1969–70 to close with a surplus of revenue over total public spending. However, there is little cause for joy in the fact that the Public Sector's income has at last, after 30 years of deficits, risen above its total spending, because the surplus comes from a massive additional burden of taxation and not from any reduction of public spending.

Consider the facts: over the ten-year period 1954–63, the Public Sector's income from taxation represented on average 33.1 per cent of the gross national product at current market prices. In 1964 the percentage taken by taxation was 33.2. In 1968 it was 41.9. In money terms, public income from taxation rose from £9,753 million in 1964 to £15,229 million in 1968, while gross public spending rose from £12,748 million (43.4 per cent of GNP) to £19,172 million (52.7 per cent of GNP).

INFLATION CONTINUES

The vast increase in taxation imposed by the present Government has been justified by successive economic overlords as necessary in order to bring about "deflation", a word which, to the man in the street, means the reverse of inflation. But the country is painfully aware that the inflation which began in 1939 still continues to erode the value of the pound. The public sees no evidence that the Government has mastered the causes of inflation, and the announcement of an anticipated Budget surplus at the end of this year has so far done little to restore internal confidence in our currency.

However, a surplus of Public Sector income over expenditure must have the effect of putting a stop to the upward pressure on prices (see our Research Paper No. 2). Provided the surplus continues to be evident, prices should become stable at a new high level. Nevertheless, it will take some time before the current high rates of taxation work their way through the practical mechanics of inflation to bring wages, costs and prices to stable levels which are mutually compatible. Not till then can the Government be seen to have mastered the causes of inflation, or be able to start repairing the great damage to the economy which followed on the wrecking of the gilt-edged market.

If there is a genuine surplus at the close of the present financial year, the managers of our public finances must immediately take action to restore the market for government long-term securities. They face a situation which, if anything, is more difficult than it was in 1946.

By 1946 the cumulative effect of the Government's inflationary expenditure, which was unavoidable in war-time, had pumped excessive liquidity into the economy. Direct controls on private expenditure, coupled with the response to savings campaigns, had left the Private Sector with a high level of "savings", of which the major part was held in Government liabilities—of one form or another—and in bank deposits. The banking system in particular had accumulated a very large holding of Government floating debt.

The gilt-edged market was under heavy strain. The Government was faced with enormous arrears of capital expenditure, due to war-time destruction, and the need to restore capital assets which had been run down during the war and the preceding depression. There was a long series of maturing obligations to be dealt with. Action taken to fund the banking system's large holdings of floating debt into short-term bonds added greatly to the list of early-maturing obligations. This already difficult situation was aggravated by additional financial obligations assumed by the Labour Government in the period 1946–51 in respect of the nationalised industries and Local Authorities. All this occurred at a time when experience of inflation and fears of more inflation were inducing investors, both private and institutional to switch out of gilt-edged and other fixed-interest securities into equities.

During the early 1950s, both the nationalised industries and local authorities embarked on very large development programmes. (Fixed capital formation by the public sector was valued at £1,300 million in 1955; and increased to £3,819 million in 1968.) With this situation overhanging the gilt-edged market, the Government found itself less and less able to raise long-term capital from the British public and so was unable to reduce the heavy list of maturities which faced it for years ahead. But instead of tackling the problem of inflation, which was the root cause of the trouble, the Government made changes in 1955 and 1956 which had the effect that ever since almost all of the capital requirements of the

nationalised industries and Local Authorities have been met by the Exchequer out of current income.

The financial situation in the first half of 1969 was as difficult as it was in 1951. Inflation had continued through 1968 because the total income of the Exchequer was never sufficient to cover total public spending on both current and capital account, and inflationary methods were used to finance the deficit. The result was that liquid financial assets of the private sector, held mainly in bank accounts and on deposit with building societies, had swollen to a total of £25,585 million at the end of 1968.

The total National Debt at the end of March 1969 was £33,963 million, of which £6,078 million was floating debt. But the banking sector's holdings of floating debt (Treasury bills and special deposits) were down to £855 million at the end of March 1969, compared with £5,740 million in March 1951. Of the £19,299 million of Government marketable securities outstanding at the end of March 1969, £5,874 million were due for redemption within the following five years.

If the public ever sees that inflation has been arrested, confidence in the stability of the pound will be restored, and the problems we have described will be easy to resolve. If the liquid funds at the disposal of the private sector were switched back into long-term Government securities, they would easily cover the redemption of maturing stocks, as well as the reduction of floating debt by conversion to long-term securities.

PUBLIC SECTOR'S REQUIREMENTS

The great difficulty in the situation of 1969 arises from the fact that the public sector's requirements of investment capital are now running at a rate of some £4,000 million a year, while the supply of new monetary saving (the net acquisition of financial assets by the private sector) has accumulated at an average rate of just under £1,000 million over the last five years. Thus, if the entire additional savings had been lent to the Government it would still not have covered the deficit. It is an intolerable state of affairs that the capital requirement of the public sector exceeded the total savings of the private sector.

The policy of the present Government is to remedy the situation by raising still more taxes. This will undermine still further the spirit of enterprise and the will to work which are already wilting under the present tax burden. The proper remedy is to insist that nationalised industries and local Authority housing yield a more adequate return on the capital they employ. It should then be possible for the difference to be made up by restoring confidence in Government securities which would enable the Government to borrow, say, half the savings of the private sector.

The figures for 1968 in the Financial Accounts of the separate sectors of the economy, recently published in the 1969 Blue Book and summarised in Table 4, reveal the situation fairly clearly.

TABLE 4

U.K. DOMESTIC ECONOMY; FINANCIAL RESOURCES AND INVESTMENT 1968

£ million

	Public Sector	Private Sector	Total community or domestic economy
SAVING: balance of income and expenditure on current account	3,012	5,504	8,516
Capital transfers	— 190	190	—
Net internal financial resources	2,822	5,694	8,516
INVESTMENT: capital expenditure on real assets Fixed capital formation	3,817	3,981	7,798
Stock-building	58	796	854
Total capital expenditure	3,875	4,777	8,652
FINANCIAL BALANCE	—1,053	+ 917	— 136

The financial deficit of £1,053 million in the public sector resulted automatically in an increase of public sector debt by an equal amount, which was acquired by the other sectors of the economy as follows:

Sector acquisitions of public sector debt, 1968

	£ million
Private sector:	
Banking system	90
Non-bank private sector	—41
Overseas sector	1,066
Total, identified items	1,115
Unidentified items	—62
Net total of sector acquisitions:	1,053

The public sector's financial deficit of £1,053 million in 1968 was thus financed entirely by the automatic transfer from the Exchange Equalisation Account to the Exchequer of the sterling counterpart of an increase in the overseas sector's holdings of public sector debt; that is to say, by the inflationary use of created money.

The negative acquisition of public sector debt by the non-bank private sector reveals that none of the private sector's financial surplus (or monetary saving), which amounted to £917 million in 1968, was absorbed by investment in real assets of the public sector. Nor, by definition, was the private sector's surplus absorbed by investment in real assets of the private sector itself. Indeed, there was a net disinvestment during the year, so that the total of identified *liquid* assets of the private sector increased by £1,844 million in 1968 alone.

In the community as a whole, saving, or the balance of income and expenditure on current account, was equal for practical purposes to the amount of the community's investment in real assets. In that sense the economy was in Keynesian equilibrium. However, separate management resulted in a financial deficit in the public sector which was approximately balanced by a financial surplus in the private sector. But the private surplus was not used to finance the public deficit; instead, the latter was financed entirely by inflation. The result is distortion of the monetary system.

The Government assumes that this intolerable situation will be remedied in the current year because a further increase of taxation will produce a Public Sector surplus. But if we do not put a stop to the present system of providing capital for the Public Sector out of current taxation, while failing to absorb into investment the accumulation of liquid savings in the Private Sector, the circular flows of the monetary system are very likely to develop a critical imbalance. Any worsening of the present situation, with floods of liquidity in some parts and acute shortages in others, could well cause a breakdown of the system. Already there are signs of approaching crises in the banking system and among the industrial companies of the private sector.

ADDITIONAL SAVINGS

But a decision to cease providing capital out of taxation, and so be in a position to reduce taxes to the point where they were merely sufficient to meet the Public Sector's current account expenditure would not by itself be sufficient. For it is obvious that the public sector's capital investment of £3,875 million in 1968 could not have been financed out of the private sector's financial surplus of only £917 million. This is the great difficulty of the financial situation of 1969. A reduction in taxation may lead to some increase in voluntary saving in the private sector, but the basic need is to raise additional savings of some £3,000 million and that is not likely to result from reducing taxes.

It would be a mistake to conclude from this that the Public Sector's need of investment capital must continue to be met from taxation, and that therefore still more taxation is inevitable.

The proper remedy is to reduce taxation and, at the same time, insist that those Public Sector undertakings which are revenue-producing—the nationalised industries and local authority housing—should earn enough to provide the additional capital they require in the same way that Private Sector industry earns enough to provide the additional capital it requires.

Our conclusion therefore, is, that the country could and should return to the former rule that capital for the Public Sector should be raised entirely by systematic and authorised borrowing at long term. But this aim cannot be achieved until the Public Sector has been made to provide the major part of its capital requirement out of surpluses from its revenue-producing activities.

This amounts to saying that the public sector must show a higher rate of return than in the past on the capital employed in the public corporations (including the nationalised industries) and in local authority housing. We are well aware that these propositions are fraught with political troubles of the most embarrassing kind. But we would point out that these difficulties have come about because political considerations have been allowed to outweigh long-established principles, and our public finances will remain in their present mess until our political leaders find the courage to tackle this thorny problem of their own creation.

CHAPTER III

Housing Rents in the context of Local Authority Finances

It is well known that the structure of our local government, which was the envy of the world only two generations ago, is now obsolescent and in urgent need of renovation. A plan for reform has been drawn up by the Redcliffe-Maud Commission on local government in England. Their report, published earlier this year, is now under consideration by the Government. But the structure of local government, and the degree of independent authority and responsibility it may exercise, is very largely determined by financial self-sufficiency, and the financial relationship with the Central Government. As matters now stand, the financial state of Local Authorities provides depressing evidence of the Central Government's poor performance in managing the country's total public finances. Unless this is improved, the mere redrawing of local boundaries will do little to restore vigour at the grass roots to the political life of the country.

The present financial position of Local Authorities in the aggregate is summarised in Table 5. It will be observed that in recent years the direct income of the Local Authorities has covered less than half the total expenditure, and that the proportion covered is falling, so that the gross deficit increases

TABLE 5

BALANCE OF TOTAL INCOME AND EXPENDITURE, LOCAL AUTHORITIES, 1959 TO 1968

£ million

	Income				Expenditure			Deficit
	Total	Rates	Rents interest, etc.	Gross trading surplus	Total	Current account	Capital account	
1959	1,091	714	329	48	2,088	1,472	616	− 997
60	1,180	771	359	60	2,251	1,592	659	−1,071
61	1,354	831	473	50	2,578	1,795	783	−1,224
62	1,444	916	474	54	2,866	1,989	877	−1,422
63	1,545	1,015	469	61	3,122	2,184	938	−1,577
64	1,708	1,119	522	67	3,553	2,388	1,165	−1,845
65	1,903	1,228	603	72	4,102	2,717	1,385	−2,199
66	2,115	1,356	687	72	4,451	3,051	1,400	−2,336
67	2,305	1,472	758	75	5,000	3,386	1,614	−2,695
68	2,518	1,595	842	81	5,500	3,709	1,791	−2,982

faster than income. In the Private Sector of the economy any person or corporation in this financial condition would be declared insolvent; in the Public Sector a large and growing deficit is disregarded, because hitherto this so-called "borrowing requirement" has been financed by the creation of new money.

The growing deficits of Local Authorities used to be financed in part by their own direct borrowing, as is shown in Table 6. But their capacity to borrow is small compared to their needs. The balance has been met from the Central Government Exchequer. It is very apparent in Table 6 that in recent years there has been no increase in direct borrowing by the Local Authorities, with the result that there has been a steep increase in their annual drafts on the Exchequer. Reading Tables 5 and 6 together it is seen that the direct income of the Local Authorities increased from £1,545 million in 1963 to £2,518 million in 1968, or by 63 per cent, while finance drawn from the Central Government increased from £939 million in 1963 to £2,400 million in 1968, or by 156 per cent. While this has been going on the managers of our economy have placed a ceiling on the amount of finance that may be provided by the banking system to the productive sector of the economy, which provides all the profits which pay for Government and Local Authority expenditure.

If the Chancellor of the Exchequer is to fulfil his promise to end deficit spending in the public sector as a whole, the

TABLE 6

FINANCIAL PROVISION TO LOCAL AUTHORITIES BY CENTRAL GOVERNMENT, 1959 TO 1968

£ million

	Deficit as in Table 5	Transfers between central government and local authorities					Direct borrowing by local authorities
		Net total transfers	To central Govt.—interest	From central government			
				Current grants	Long-term loans	Capital grants	
1959	− 997	+ 588	−123	+ 711	− 35	+ 35	+409
60	−1,071	+ 665	−123	+ 780	− 36	+ 44	+406
61	−1,224	+ 728	−124	+ 828	− 21	+ 45	+496
62	−1,422	+ 822	−124	+ 926	− 35	+ 55	+600
63	−1,577	+ 939	−123	+1,031	− 31	+ 62	+638
64	−1,845	+1,279	−125	+1,159	+172	+ 73	+566
65	−2,199	+1,639	−142	+1,249	+455	+ 77	+560
66	−2,336	+1,938	−171	+1,481	+546	+ 82	+398
67	−2,695	+2,014	−203	+1,706	+398	+113	+681
68	−2,982	+2,400	−235	+1,899	+589	+147	+582

trend of the Local Authorities towards ever-increasing deficit spending must be reversed. It is impractical to suggest cutting Local Authority expenditure; no doubt there is room for economies under some heads, but expenditure on education for example must increase, and much else remains to be done to modernise our civic environment. If expenditure cannot be reduced, then financial management must be directed towards two aims: first to finance all capital expenditure by long-term borrowing, and secondly to increase income to a level at which the current account is balanced after meeting the cost of servicing loan-capital.

This whole question of local authority finance, though neglected for years by successive governments, has been the subject of many important studies and recommendations by commissions and interested organisations. The Institute of Municipal Treasurers and Accountants, in particular, has published some very valuable studies on the problems of finding additional or alternative sources of income for the local authorities.* There is little we can usefully add to the comprehensive work already completed by experts with special competence. But we may, perhaps, draw attention to the financial situation of local authority housing, details of which were recently published in the 1969 Blue Book and are reproduced in Table 7.

TABLE 7

INCOME AND EXPENDITURE OF THE PUBLIC SECTOR ARISING FROM LOCAL AUTHORITY HOUSING

£ million

	Income from rents received	Current Expenditure: Maintenance and administration	Current Expenditure: Loan charges other than to central govt.	Current Expenditure: Total current expenditure	Deficit on current account, subsidised by public sector	Capital expenditure on construction of new dwellings	Net total cost of local authority housing to public sector
	1	2	3	4 (2+3)	5 (4−1)	6	7 (5+6)
1959	192	80	211	291	99	253	352
60	210	85	229	314	104	255	359
61	227	93	252	345	118	273	391
62	254	101	270	371	117	321	438
63	282	113	287	400	118	365	483
64	307	117	318	435	128	495	623
65	341	137	364	501	160	545	705
66	384	146	411	557	173	655	828
67	433	172	449	621	188	753	941
68	490	200	504	704	214	785	999

* Sources of Local Government Finance—Sales Tax; Motor Tax; Local Charges; Local Income Tax; Rates; published by The Institute of Municipal Treasurers and Accountants, 10/- each.

The situation revealed in Table 7 is that the taxpayers of the community at large provide local authority housing for a substantial part of the population at rents which do not even cover the related current outgoings. The result is a growing deficit on current account, amounting to £214 million in 1968, which is subsidised ultimately by the country's taxpayers. On top of this the taxpayers are providing investment capital out of their current income for the construction of more local authority housing in amounts which have more than tripled in the last ten years and amounted to £785 million in 1968. In total, therefore, the net cost to the taxpayer out of current income to provide local authority housing for a part of the population is now £1,000 million a year, and is rapidly rising.

Simple arithmetic shows that the burden on the taxpayer could be much reduced by doubling or tripling rents. In relation to the average level of workers' take-home pay, and the costs of mortgage-loans to buy similar dwellings, this is a reasonable proposal. But political considerations may require that the problem should be tackled selectively over a period of some years. Its general solution could be eased, we suggest, by a vigorous national campaign to sell these properties to the sitting tenants on terms approximating to those for private house-purchase with a building-society mortgage. As the capital cost of these dwellings (not less than £10,000 million) has been provided in large part out of current taxation there would be no need to raise loans to make these purchases, and the sales could proceed very much on the lines of hire-purchase which is financed by the seller himself.

Finding a solution which is both practical and socially just is essential for the restoration of sound management to our public finances, and should therefore be given the very highest priority by any Government which claims to be responsible.

CHAPTER IV

Public Corporations and Nationalised industries

A White Paper published in November 1967 (Cmnd. 3437) explained the procedure by which targets were set for each of the Public Corporations, taking into account investment, pricing and efficiency. The House of Commons Select Committee on the Nationalised Industries maintains a watch on their performance. This should ensure that the return on capital invested is adequate; therefore, that resources are efficiently used and that the rate of return is in accord with the current interest rates.

While some people may think the return on capital adequate, the method of raising additional capital is most disquieting. Since 1955 virtually the whole additional capital requirement has been met by the Exchequer by loans (plus capital grants to the write-off of debt).

TABLE 8

PUBLIC CORPORATIONS AND NATIONALISED INDUSTRIES: SOURCES OF FINANCE FOR FIXED CAPITAL FORMATION, 1959 to 1968

£ million

	Expenditure on fixed capital formation	Financed from internal resources	Provision of capital by central government
1959	758	142	616
60	788	305	483
61	905	362	543
62	933	440	493
63	1,024	646	378
64	1,187	609	578
65	1,293	624	669
66	1,455	623	832
67	1,662	503	1,159
68	1,647	514	1,133

Details of this provision of capital by the Central Government, in relation to expenditure on fixed capital formation, are given in Table 8. This table shows that, although expenditure on fixed capital formation has steadily increased, the amount of income that has been ploughed back as capital has declined since 1963, with the result that the amount of capital provided from the Exchequer has recently expanded greatly, and totalled £3,793 million over the four years 1965–68.

None of this capital requirement in the last four years was raised by the Treasury by borrowing from the non-bank private sector, whose holdings of public sector debt decreased by a net £51 million over this period.

The point to be noted, however, is that the capital provided by the central government over the four years 1965–68 to the public corporations (£3,793 million) and to the local authorities (£2,407 million) could not have been raised by borrowing from new personal savings, which totalled only £2,924 million in this period. This means that the restoration of equilibrium requires modification of the pricing policy applied to the public corporations and nationalised industries, in order that they may be able to provide most, if not all, of their capital requirements out of their own trading profits.

APPENDIX
TABLE A
PUBLIC SECTOR—INCOME
£ million

	TOTAL INCOME	Taxes and Levies					Other income				
		Total	Taxes on income	Taxes on expend-iture	Taxes on capi-tal	Nat'l insur-ance and health contri-butions	Total	Rent, interest and divi-dends	Gross trad-ing sur-plus	Grants from over-seas govts.	Misc. capi-tal trans-actions
1959	8,247	7,056	2,747	3,200	212	897	1,191	564	555	—	72
60	8,711	7,253	2,713	3,391	236	913	1,458	598	718	—	142
61	9,591	8,040	3,066	3,643	259	1,072	1,551	747	741	—	63
62	10,483	8,806	3,447	3,896	266	1,197	1,677	781	822	—	74
63	10,829	9,039	3,379	4,049	308	1,303	1,790	735	924	—	131
64	11,695	9,753	3,523	4,478	308	1,444	1,942	797	1,022	—	123
65	13,017	10,989	4,020	4,994	290	1,685	2,028	914	1,091	—	23
66	14,360	12,129	4,419	5,591	315	1,804	2,231	1,019	1,136	—	76
67	15,677	13,335	5,084	6,005	339	1,907	2,342	1,089	1,202	—	51
68	18,032	15,229	5,637	6,987	434	2,171	2,803	1,165	1,449	—	189

APPENDIX
TABLE B
PUBLIC SECTOR—EXPENDITURE
£ million

	TOTAL EXPENDI-TURE	Current Account						Capital Account		
		Total	Direct exp. on goods and ser-vices	Social security and other grants to persons	Subsi-dies	Grants paid over-seas	Debt interest	Total	Gross domestic fixed capital forma-tion	Other capi-tal expend-iture
1959	8,810	7,079	3,919	1,637	369	82	1,072	1,731	1,592	139
60	9,425	7,577	4,163	1,654	487	94	1,179	1,848	1,648	200
61	10,304	8,275	4,497	1,804	586	118	1,270	2,029	1,824	205
62	10,999	8,814	4,822	1,983	600	121	1,288	2,185	1,962	223
63	11,687	9,303	5,080	2,237	560	132	1,294	2,384	2,132	252
64	12,748	9,807	5,395	2,371	510	163	1,368	2,941	2,580	361
65	14,201	10,856	5,915	2,732	564	177	1,468	3,345	2,776	569
66	15,352	11,715	6,427	2,975	556	180	1,577	3,637	3,133	504
67	17,573	13,153	7,087	3,359	790	184	1,733	4,420	3,639	781
68	19,172	14,399	7,565	3,840	885	180	1,929	4,773	3,819	954

Published by
The Sponsoring Committee of the National Recovery Programme
10 Upper Berkeley Street, London, W.1

Printed by
Maxwell, Love & Co. Ltd., London, S.E.1 (C 11/69)

NATIONAL RECOVERY PROGRAMME
CO-OPERATING ORGANISATIONS

COMMONWEALTH INDUSTRIES ASSOCIATION LTD

Chairman—Rt. Hon. Robin Turton, M.C., M.P.

Director—Edward Holloway.

Secretary—Miss H. V. L. Packer.

Objects: To strengthen the Commonwealth and Sterling Area, to maintain free enterprise, to aid development in the newly independent Commonwealth countries, to encourage Commonwealth shipping and air services and to protect U.K. industry and agriculture from unfair forms of competition.

There is a strong Parliamentary Committee constantly active in both Houses. The Association has a panel of highly qualified lecturers and issues a Monthly Bulletin. Further details and copy of Bulletin from The Secretary, Commonwealth Industries Association Ltd., 60, Buckingham Gate S.W.1. Telephone: 01-834 4688.

ECONOMIC RESEARCH COUNCIL

President—Lord Beeching.

Chairman—Patrick de Laszlo.

Honorary Secretary—Edward Holloway.

Object: To promote education in the science of economics, with particular reference to monetary practice.

Membership is open to all who are in sympathy with its objects. Minimum Annual Subscription £2 2 0. Further details from Economic Research Council, 10 Upper Berkeley Street, London, W.1. Telephone: 01-262 8646.