CHAPTER 7
PUBLIC EXPENDITURE PLANS AND FISCAL POLICY

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Introduction

This chapter falls into two parts. The first contains an analysis of the recent Public Expenditure White Paper (*Cmnd.* 6721-I), comparing the latest plans for public spending both with what was previously proposed and with the rate of expansion in the past. An estimate is made of the true scale of the successive cuts to public expenditure announced during 1976 for 1977-78 and 1978-79.

The second part sets out how, in our opinion, public expenditure plans ought to be presented in the annual Public Expenditure White Paper. We incorporate the plans contained in the January 1977 White Paper in a complete set of public sector accounts, constructed on explicit assumptions about tax rates, output growth, the balance of payments and the rate of inflation, thereby filling a gap left by the omission of revenue projections from the White Paper. This enables the implications of the plans for the government's fiscal stance over the next few years to be examined.

The government's public expenditure plans

On three separate occasions during 1976, decisions were taken to reduce the public sector's absorption of resources and borrowing requirement in the two financial years 1977-78 and 1978-79. In this section we assess those measures and other changes made during the year, as consolidated in the January 1977 White Paper. It is not yet possible to come to any firm conclusions about the implied absorption of resources, because the estimates in the White Paper are valued exclusive of the relative price effect.[1]

The main points to emerge from the analysis are, first, that while the latest estimates of total public expenditure incurred in 1975-76 and 1976-77 are lower than shown in the February 1976 White Paper, they are nevertheless higher than forecast in January 1975. Second, total public expenditure is now forecast to remain virtually constant in volume terms over the period 1976-77 to 1978-79; within the total, there is a decline in spending on goods and services, which is concentrated on capital projects. Third, present plans entail a sharp check to the persistent tendency over the past 20 years for public consumption, and the absorption of manpower, to grow at a rate of around 3 per cent a year.

The overall picture is one of a restraint on public expenditure – with the exception of debt interest – which is unprecedented since the rundown in military expenditure after the Korean war.

The movement in public expenditure over the period 1975-76 to 1978-79 as shown by the January 1977 White Paper is compared in Table 7.1 with that implied by the forecasts in the two previous White Papers. Expenditure on financial transactions, such as the purchase of land or various forms of lending, is excluded from the series in the table, since transactions of this kind cause little demand for currently produced output. Nationalised industries' expenditure is also excluded, because the figures are not yet available.[2]

Out-turn in 1975-76 and 1976-77

Between the January 1975 and February 1976 White Papers, the estimate of total public expenditure for 1975-76 was revised upwards by almost 2 per cent and that for 1976-77 by over 4 per cent. The estimate of out-turn for both years in the January 1977 White Paper is $\frac{1}{2}$ to $1\frac{1}{2}$ per cent lower than it appeared in February 1976, but it still remains higher than the estimates made in January 1975. Indeed the upward revision for 1976-77 over the period as a whole amounts to £1,600 million at 1976 Survey prices[3] or 3 per cent, although virtually all of this is attributable to an increase in the estimate for debt interest.

Indeed the successive revisions to the forecast of debt interest, together with social security payments, are responsible for much of the variation in the estimate of total spending in 1976-77 as between the three White Papers summarised by Table 7.1. The debt interest estimate for 1976-77 was revised upwards by £2,000 million between January 1975 and February 1976 and subsequently reduced by £500 million in January 1977. Expected social security payments were first revised upwards by over £500 million and then downwards by £400 million.

The estimate of expenditure on goods and services in 1976-77, on the other hand, shows the opposite pattern of change. Subsequent revisions have offset the cuts to expenditure on this category for 1976-77 (amounting to £800 million) announced in the April 1975 Budget, so that the latest forecast of out-turn is almost identical to that made in January 1975, before the cuts.

Planned public expenditure in 1977–78 and 1978–79

Total public expenditure (excluding financial transactions and nationalised industries) is planned, according to the January 1977 White Paper, to remain virtually constant at its 1976-77 level in both 1977-78 and 1978-79.[4] The White Paper, however, includes forecasts of debt interest for both years which we

[1] The relative price effect measures the tendency for public sector costs to increase faster than average prices over the economy as a whole. The exclusion of this factor from the price basis means that the opportunity costs of public expenditure will tend to be progressively understated the further ahead projections of expenditure are made.

[2] Details of nationalised industries' expenditure are not shown in Cmnd. 6721-i, as this is no longer considered as part of public expenditure; details will appear, however, in the second volume of the White Paper.

[3] In this section, sums of money are valued at 1976 Survey Prices unless otherwise stated.

[4] No allowance is made here for the 'further fiscal adjustment' of £500 million to 1978-79, announced by the Chancellor in December. The form of this is still to be decided, but if the entire reduction fell on public expenditure, as defined here, it would mean a fall of just under 1 per cent between 1977-78 and 1978-79.

Table 7·1 Public expenditure by economic category, 1975-76 to 1978-79, according to successive White Papers: indices derived from 1976 Survey price estimates, excluding relative price effect

	Average annual % change 1972-73 to 1975-76	Expenditure in 1975-76, £ million at 1976 Survey prices	1975-76 in Jan. 1975 White Paper=100			
			1975-76	1976-77	1977-78	1978-79
Expenditure on goods and services, excluding nationalised industries						
January 1975 White Paper		29,607	100·0	102·7	104·9	106·6
February 1976 White Paper			101·1	101·2	100·5	99·1
January 1977 White Paper	+3·2		101·2	102·6	98·2	97·0
Debt interest						
January 1975 White Paper		5,125	100·0	96·9	92·9	90·9
February 1976 White Paper			110·1	136·6	154·1	165·9
January 1977 White Paper	+5·4		106·8	126·8	142·4	144·4
Other transfers						
January 1975 White Paper		18,286	100·0	102·6	105·6	109·6
February 1976 White Paper			100·4	106·5	104·9	104·3
January 1977 White Paper	+8·0		99·3	103·5	105·7	107·3
Total expenditure, excluding nationalised industries and financial and asset transactions						
January 1975 White Paper		53,018	100·0	102·1	104·0	106·1
February 1976 White Paper			101·7	106·5	107·2	107·3
January 1977 White Paper	+4·9		101·1	105·2	105·1	105·1

Note: See Appendix Table 7.A1 for details of derivation.

think are almost certainly too high. Our own forecast shows debt interest remaining much the same at constant prices in 1977-78 as in 1976-77, as opposed to the Treasury forecast of a 12 per cent increase. Given that the Treasury have often been very inaccurate in the past in estimating this item, a more valuable indication of the future movement in expenditure may be gained by omitting debt interest projections from the White Paper series. If this is done, the fall in total public spending between 1976-77 and 1977-78 becomes 2 per cent, the change in the subsequent year remaining negligible. A fall of 2 per cent contrasts with an average increase in total expenditure of 5 per cent a year in the period 1972-73 to 1975-76.

Comparisons with previous expenditure plans

The present plans entail a reduction of 2 per cent, around £1,100 million, in the level of total spending proposed for both 1977-78 and 1978-79 in the February 1976 White Paper. Downward revisions to the forecasts of debt interest account for a large part of this reduction with respect to both years. Excluding debt interest, the estimate of total public expenditure in the January 1977 White Paper for 1977-78 is only some £500 million lower than forecast a year earlier and for 1978-79 hardly any lower at all. This is despite the cuts announced by the Chancellor in July and December, which amounted in aggregate to over £2 billion and almost £1½ billion, respectively. In both cases, a significant proportion of the cuts – almost 30 per cent for 1977-78 – consisted of reductions in asset and financial transactions, which we exclude from our calculations, while additions to forecast expenditure made over the year serve to cancel out much of the remaining cuts.[1]

Nevertheless, total public expenditure exclusive of debt interest is now planned to be £2 billion less in 1977-78 than proposed before the February 1976 White Paper and £3½ billion less in 1978-79.

The greater part of this reduction falls on goods and services, the proposed spending on which has been cut by 9 per cent, or by £2,800 million, in 1978-79 since the January 1975 White Paper (Table 7.1).

Planned expenditure by economic category

The result of these successive changes in plan is that expenditure on goods and services is now intended to fall by over 4 per cent from 1976-77 to 1977-78 and by a further 1 per cent in 1978-79. This compares with an average growth of over 3 per cent a year in the period 1972-73 to 1975-76.

As so often in the past, it is expenditure on capital projects which bears the brunt of the cutback in the public sector's direct absorption of goods and services. At constant Survey prices, present intentions are that capital expenditure – other than that undertaken by nationalised industries – will fall by 16 per cent from 1976-77 to 1977-78 and by a further 6 per cent in

[1] The magnitude of the reduction obtained depends to some extent on what assumption is made about the allocation between economic categories of the contingency reserve in successive White Papers. This is inevitably fairly arbitrary, but it is clear from the commentary in the White Papers that it has mainly been intended to provide for additional spending on transfers and lending.

1978-79.[1] Reductions on this scale are unprecedented in the post-war period.[2] Moreover they come at a time when the construction industry, which is heavily dependent on public sector projects, is in a deep recession.

Current expenditure on goods and services is planned to decline by 1½ per cent, at constant Survey prices, between 1976-77 and 1977-78 and to remain at about the same level in 1978-79. In the past, actual reductions in the volume of public consumption between one year and the next have been achieved only by substantial cuts in military expenditure, civilian expenditure increasing persistently by around 3 per cent a year, at constant prices, over the past 20 years.[3] The planned reduction in the defence programme between 1976-77 and 1977-78 is, however, only 3 per cent, and there is a reduction in civil expenditure of 1 per cent. Even a fall as small as this represents a significant cutback in relation to the past trend.

The movement in transfer payments shown in Table 7.1 is heavily influenced by the debt interest forecasts. Excluding debt interest, transfers show a small increase between 1976-77 and 1978-79, though the planned level of spending in 1978-79 is about 2 per cent, or over £400 million, lower than forecast in the January 1975 White Paper, subsidies being the main element to be reduced. Nevertheless there has been a net addition to this category of expenditure since the February 1976 White Paper, of over £500 million.

The government's fiscal stance

In July 1976, a substantial upward revision to the official forecast of GDP growth for 1977 prompted the Chancellor to take discretionary fiscal action aimed at reducing the public sector borrowing requirement to around £9 billion in 1977-78. A substantial downward revision to the growth forecast from 4½ to 2 per cent in the subsequent months was associated with an increase in the projected borrowing requirement to £10½ billion. This prompted further discretionary measures to be taken in December with the object of meeting 'the government's aim to hold the public sector borrowing requirement to £8·7 billion in 1977-78'.[4]

The government's decision to make the *ex post* borrowing requirement[5] an unconditional target carries the implication that if, for any reason – such as a fall in exports or rise in savings – income and activity fall and the borrowing requirement correspondingly increases, fiscal action is taken to tighten the budget, so reducing activity further.

A rational fiscal policy can, in our view, only be determined – and fiscal stance satisfactorily assessed – by reference to a measure of the budget deficit which isolates the effects of discretionary changes in tax rates or expenditure programmes from the automatic changes caused by variations in activity.

Such a measure is the 'constant employment' financial balance, which we define here as the balance which would result from the government's present public expenditure plans, at existing but fully revalorised tax rates, if the pressure of demand – as measured by the rate on unemployment – were to remain at its average 1976 level and a given foreign balance achieved.[6] The employment assumption, it should be emphasised, is a neutral one and not intended to imply anything about what the government's employment target should be.

Our medium-term projections of the constant employment financial balance are based on a GDP growth rate of 3¾ per cent a year, which, according to the analysis reported in Chapter 1, would be necessary to keep the pressure of demand at its 1976 level, ignoring adjustment lags and such short-term influences as the Temporary Employment Subsidy and Job Creation Scheme.

The balance-of-payments requirement is specified in terms of the basic balance (i.e. the potential for debt repayment), since it is more important than the current account balance in Britain's present circumstances.[7] It is assumed that the amount of debt repaid amounts to £4 billion by 1981; this is associated with a balance-of-payment surplus on current account of around £1 billion, at 1975 prices, in both 1978 and 1979, though slightly lower thereafter.

The estimates are based on the assumption that the rate of inflation of consumer prices declines to around 10 per cent in 1978 and then remains at that figure. The precise rate of inflation assumed, however, has little impact on the financial balance, at constant prices, if tax rates, allowances and benefits are assumed to be completely revalorised, as long as there are no abnormal differences in the rate of price increase between the private and public sectors – as occurred for example in 1974-75.

The estimation process is equivalent to that explained in last year's *Review*. Public sector receipts at a constant pressure of demand are derived by assuming that private expenditure and private income are separately adjusted to levels consistent with the rate of output growth and foreign balance requirements specified, given existing tax rates and expenditure programmes.[8] Both requirements are assumed to be achieved *via* a growth in net exports. Both revenue and expenditure are initially computed in money terms and then converted to constant price terms by use of the domestic expenditure deflator. This implies that public expenditure is defined to include the relative price effect – estimated in the model – which is a

[1] The series in Appendix Table 7.A1 from which these figures are derived exclude net purchases of land and existing buildings, which are included as part of the category in the White Paper and official accounts.

[2] In the post devaluation squeeze, for example, between 1968 and 1969, public investment, *including* nationalised industries, declined by 6 per cent in volume terms, with the greater part of the reduction falling on nationalised industries.

[3] By around 5 per cent a year including the relative price effect.

[4] *The Government's Expenditure Plans*, Cmnd. 6721-i, January 1977, para. 50.

[5] *Ex post* in the sense of the borrowing requirement which is actually expected to emerge after the event, as opposed to an *ex ante* concept associated with a given level of activity, balance of payments and rate of inflation.

[6] This measure is akin to the full employment financial balance defined in last year's *Review* (Chapter 7), where we arbitrarily took 650 thousand unemployed as the full employment level, and assumed a zero balance of payments on current account to be continuously achieved.

[7] This is more fully explained in Chapter 1 above.

[8] Private income has to be consistent with national income at a constant pressure of demand less public sector property income. As actual tax rates are unlikely to be the same as those necessary to limit (or raise) private expenditure to a level which is consistent with the resources available, after meeting the prior claims of the public expenditure authorisations at present in force and of net exports, the private sector financial balance is assumed to be out of balance to the same extent as the public financial balance is out of balance.

Table 7·2 Public sector receipts, expenditure and the financial balance at 'constant employment' 1976 to 1981, £ million at 1976 values

	1976	1977	1978	1979	1980	1981
Total public sector receipts	47,180	48,520	51,570	55,650	58,770	61,970
of which: North Sea oil	140	320	740	1,350	1,850	2,310
Total public expenditure	56,510	56,200	56,380	57,720	59,380	61,330
Financial balance, excluding capital taxes, and asset purchases	−9,330	−7,680	−4,810	−2,070	−610	640
Borrowing requirement	*10,200*	*8,030*	*4,810*	*2,570*	*1,030*	*−420*

Notes: See Appendix to this chapter for details of the derivation of the figures.

necessary requirement for both sides of the public sector account to be displayed in the same table and for them to yield a meaningful balance.

These assumptions form the basis of the estimates of public sector receipts, expenditure and the financial balance summarised in Table 7.2 for each of the years 1976 to 1981.

The public sector financial balance in 1976

The public sector financial deficit, defined to exclude capital taxes and asset transactions, is estimated at £9,330 million in 1976 (Table 7.2). This compares with the April 1976 Budget forecast for the financial year which is unlikely to diverge very much from the calendar year – of £11,000 million, on the same definition. The rate of GDP growth has been less than forecast at the time of the Budget while the rate of inflation has been higher. Under normal circumstances both factors would be expected to cause the financial balance to turn out to be higher than estimated at the beginning of the year – their combined effect being perhaps as much as £1 billion. In 1976, however, the effect of the rigid application of cash limits on public expenditure, together with a successful incomes policy – especially as far as the public sector is concerned – may well have reduced the financial balance by more than the lower rate of output growth increased it.

There is insufficient information to estimate the size of these two opposing influences. Two factors which clearly were important in reducing the deficit are, first, that grant payments are likely to fall short of the April estimate by around £500 million and second, that rent and interest receipts are almost certain to prove higher than estimated.[1]

The constant employment balance, 1976 to 1981

Table 7.2 shows that on the present plans the constant employment financial balance will decline sharply in 1977 and 1978, at existing (revalorised) tax rates. In terms of 1976 prices, the financial deficit declines from £9·3 billion to £7·7 billion between 1976 and 1977, a fall of almost 2 percentage points in relation to GNP at factor cost. This is entirely a consequence of the reduction in public expenditure: indeed total public sector receipts increase less than in proportion to the growth in GNP, largely because of a projected relative decline in those tax bases (wages and salaries and consumers' expenditure) which bear relatively high effective tax rates. Moreover, the large increase in profits in 1977 does not immediately give rise to any significant increase in tax revenue, because of the long lag in payments of taxes on profits.

The financial deficit falls to £4·8 billion at 1976 prices in 1978, again mainly as a result of the restraint on public expenditure growth, though also because of an increase in public sector receipts relative to GNP. The latter is largely explained by a marked rise in tax revenue from property income, the source of which is the growth in company profits in 1976. It also results from the emergence, on any significant scale, of tax receipts from the North Sea (mainly royalties at this stage), which amount to an estimated £750 million by 1978.

The decline in the constant employment financial deficit continues at much the same rate in 1979, though this is more the result of an increase in public sector receipts – and North Sea revenue in particular – relative to the growth in output than of a decline in public expenditure.

The main conclusion to be drawn from Table 7.2 is that present public expenditure plans imply that, in the absence of cuts in real (as distinct from nominal) tax rates, there will be a significant tightening in the fiscal stance over the medium term and in particular over the period 1976 to 1979. Over these three years, the financial deficit is reduced by 7 percentage points of GNP. This is similar to the reduction achieved (on a constant employment basis) in the post-devaluation period 1967 to 1970, though then increases in tax rates were more important than cuts in expenditure and the initial level of unemployment was considerably lower (2 per cent as against over 5 per cent).

From 1979 onwards, the estimates are more speculative because of the absence of published government forecasts of public expenditure for the years after 1978-79. Table 7.2 does show, however, the increasingly important effect on public sector receipts of North Sea revenue, which rises to over £2 billion by 1981 on our estimates. This, together with the buoyancy of income tax (after revalorisation of tax rates) is largely responsible for the continued rise in public sector receipts in relation to GNP from 1979 onwards. By contrast, public expenditure is projected to show a relative decline, though substantially less marked than in 1977 and 1978. The net result is that the financial deficit becomes negligible by 1980 and is transformed into a small surplus in 1981.

[1]The January 1977 White Paper shows a shortfall in social security payments of £400 million for 1967-77 and capital transfers appear to have been much affected by lower than expected investment. Higher rent and interest receipts may be partly attributable to the increase in interest rates over the year.

Table 7·3 Public sector receipts, expenditure and the financial balance at GDP growth rates of 5 per cent and 2 per cent a year, 1976 to 1981

£ million at 1976 values

	1976	1977	1978	1979	1980	1981
GDP growth of 5 per cent a year						
Public sector receipts	47,180	48,950	52,400	57,150	61,000	64,950
Public expenditure	56,510	56,200	56,250	57,400	58,800	60,450
Financial balance	9,330	−7,250	−3,850	−250	2,200	4,500
GDP growth of 2 per cent a year						
Public sector receipts	47,180	47,950	50,400	53,550	55,800	58,000
Public expenditure	56,510	56,250	56,550	58,150	60,200	62,600
Financial balance	−9,330	−8,300	−6,150	−4,600	−4,400	−4,600

Notes: The assumptions relating to tax rates, inflation and the balance-of-payments target are identical to those described with respect to Table 7.2. Public sector receipts are inclusive of subsidies, which are excluded from public expenditure. Capital taxes, net purchases of existing assets, net lending and other financial transactions are excluded throughout. The series for public sector receipts and expenditure are initially computed at current prices, then converted to 1976 prices by a common deflator (the domestic expenditure deflator); public expenditure is therefore measured inclusive of the relative price effect.

The financial balance on different growth assumptions

The effect of dropping the assumption that the pressure of demand is held at the 1976 level is illustrated in Table 7.3. This shows total public sector receipts, expenditure and the financial balance in each of the years 1976 to 1981, on the alternative assumptions that the growth of domestic output averages 2 per cent a year and 5 per cent a year. The balance-of-payments target (debt repayment of £4 billion by 1981) and the assumed rate of inflation (around 10 per cent a year increase in consumer prices) are the same as in Table 7.2.[1]

At a growth rate of 2 per cent a year, the financial deficit still falls markedly (by almost 5 percentage points of GNP) up to 1979 – reflecting the magnitude of the planned reduction in public expenditure; it then remains almost constant at 1976 prices. At a growth rate of 5 per cent a year, the financial deficit is virtually eliminated by 1979 and becomes a substantial surplus by 1981 (when unemployment is still over one million).

A comparison of the two sets of projections shows that the effect on the financial balance of different rates of output growth widens progressively over time. In the first year, a growth rate of 5 per cent as opposed to 2 per cent causes an additional reduction in the financial deficit of around £1 billion at 1976 prices (almost 1 per cent of GNP), as a result of the extra revenue yielded. By the third year, a continued difference of 3 per cent a year in the rate of output growth reduces the financial deficit by £2 billion (over 1½ per cent of GNP), and by the sixth year the figure approaches £3 billion (2 per cent of GNP). This pattern is largely the consequence of a differential effect on expenditure. For, given spending authorisations, the level of public sector outlays is higher if GDP grows at 2 per cent than if it grows at 5 per cent, because of additional unemployment benefit and subsidy payments. It also means a higher borrowing requirement and consequently higher debt interest payments. The longer the difference in growth rates persists, the greater the differential impact on unemployment and the greater the difference in public sector debt accumulated, and therefore the greater the differential impact on benefit payments and debt interest.

[1]The device for generating different rates of GDP growth, as with the constant employment estimates, is to adopt an appropriate assumption about the growth in net exports.

The Chancellor's borrowing requirement targets for 1977-78 and 1978-79

The 2 per cent a year GDP growth assumption in Table 7.3 corresponds approximately to the latest government forecast for 1977-78 and 1978-79 (2 per cent in the former, 2½ to 3 per cent in the latter) on which the Chancellor based his declared objective of achieving borrowing requirements of £8·7 billion, at current prices, in 1977-78 and 1978-79 respectively. The question arises as to whether the discretionary changes in fiscal policy already announced are consistent with the attainment of that objective.

Adjusted to current prices and to include financial transactions and capital taxes, the estimates in Table 7.3 produce borrowing requirements of £9½ billion in 1977 and £7½ billion in 1978. The former is consistent with a borrowing requirement of around £9 billion or slightly less in the financial year 1977-78, and is not significantly different from the Chancellor's objective. Our estimates, however, are calculated on the assumption of full revalorisation of 1976 tax rates. This implies that there is scope for *nominal* tax reductions in the coming Budget – the more so since some increase in rates of specific duty was announced in December – but not for *real* reductions if the borrowing requirement target is to be met. The size of the possible changes in nominal tax rates to achieve revalorisation is illustrated by the calculation that an increase in income tax allowances worth around £1·2 billion in terms of tax revenue forgone would offset a rate of inflation of around 12 per cent for 1977-78; but it would need to be accompanied by a further increase in rates of specific duty about equal to that announced in December (i.e. yielding £250 to £300 million additional revenue).

For 1978-79, our estimates produce a borrowing requirement of less than £7½ billion at current prices as against the Chancellor's target of £8·6 billion, on the basis, moreover, of a slightly lower growth of domestic output. This suggests that the *present* fiscal stance, instead of needing to be tightened by the further

£500 million to which the Chancellor committed himself in Decembei and which is incorporated in our estimates,[1] could instead be relaxed by about that amount consistently with the achievement of his target borrowing requirement. It is however early to be arriving at nice conclusions about the measures needed to attain in 1978-79 a fiscal target of this kind.

APPENDIX

Notes to Table 7·A1

Nationalised industries' capital expenditure is excluded throughout, since no details are given in the January 1977 White Paper. 'Shortfall' in the January 1975 and February 1976 White Papers has been deducted from capital expenditure. The contingency reserve has been divided between transfers and financial transactions. Purchases less sales of land and existing buildings, which is included in the figures for capital formation in the White Paper, is deducted from this category and is included with financial transactions. Investment grants are excluded throughout.

The February 1976 White Paper series are derived from the revisions by economic category shown in *Cmnd.* 6721 to have been made since the preceding White Paper.

The January 1975 White Paper series are derived by taking the revisions to programmes shown in the February 1976 White Paper to have beeen made between January 1975 and February 1976. These are in terms of 1975 Survey prices and have been approximately converted to 1976 Survey prices by applying to them revaluation factors derived for each programme, on the implicit assumption that the price change between the two Surveys is the same for revisions as for the programme as a whole.

We rejected the alternative procedure of merely comparing the movement in expenditure at different Survey prices shown by successive White Papers, because a comparison of past years revealed that changes in the price basis had a significant effect on year-to-year movements.

The estimates of public expenditure and receipts, 1976 to 1981

Table 7.A2 sets out the full estimates of constant employment public sector receipts, expenditure and the financial balance. These are based on the assumptions that the rate of GDP growth is 3¾ per cent a year – generated by a growth of net exports – that the rate of inflation is around 10 per cent a year from 1978 onwards and that the basic balance of payments is such as to enable debt repayment of £4 billion, at 1975 prices, to be made by 1981. 'Constant employment' public sector receipts and expenditure are defined to be those which would obtain if private expenditure and private income were separately adjusted to levels consistent with these assumptions, given existing tax rates and spending authorisations. Estimates are initially calculated at current prices and then converted to constant 1976 prices by means of the domestic expenditure deflator.

[1]See Appendix to this chapter.

The tax rates from which receipts are derived are those prevailing during 1976, fully revalorised (personal income tax allowances higher rate bands as well as specific duty rates). Changes in tax rates already announced, such as the surcharge on national insurance contiibutions to take effect from April 1977, are taken into account. The estimates therefore incorporate an allowance for the transition from the present system of child tax allowances and family allowances to the child benefit scheme by 1979 which is part of government policy. This is to be achieved in the first instance by freeing present family allowances from income tax, introducing a flat-rate allowance (of £1) for the first child and reducing child tax allowances by almost a third. Thereaftei it is assumed that a two-stage elimination of child tax allowances is matched by an increase in child benefits of an equivalent average value. The effect on the public sector accounts is to raise expenditure on welfare benefits and revenue from income tax by the same amount.

The public expenditure estimates are derived partly from the January 1977 White Paper – though they are expressed inclusive of the relative price effect – which only extends to 1978-79, and partly from assumptions about the likely course of expenditure in the years after 1978-79 based on numerous official statements about present government intentions. As regards 1978-79, the Chancellor stated in December that 'a further fiscal adjustment of £½ billion at 1976 prices' would be made, in addition to the measure already announced. It is assumed that this falls on public expenditure, being achieved by the simple expedient of not allocating all of the contingency reserve for that year in the January White Paper to categories of expenditure.

Even inclusive of the relative price effect, current expenditure on goods and services is shown to increase by only 1 per cent between 1976 and 1978. This is a consequence not only of the successive cuts to programmes analysed above, but also of public sector wages being projected to increase at a rate not much higher than the domestic expenditure deflator. The relative price effect is therefore close to zero. In the years after 1978, it is assumed that there is a resumption of the growth in public consumption but at a slower rate than in the past. The relative price effect contributes around 2 per cent a year to the increase, which is in line with the historical norm.

Capital expenditure, by contrast, is assumed to grow relatively rapidly, at an average rate of 5½ per cent a year, between 1979 and 1981 as a reaction to the sharp

Table 7A·1 Public expenditure by economic category, forecasts and out-turn, 1975-76 to 1978-79; indices derived from 1976 Survey price estimates, exclusive of relative price effect

	Expenditure in 1975-76 £ million at 1976 Survey prices	1975-76 in Jan. 1975 White Paper = 100			
		1975-76	1976-77	1977-78	1978-79
Current expenditure on goods and services					
January 1975 White Paper	23,894	100·0	102·9	105·4	107·0
February 1976 White Paper		100·6	102·3	102·4	102·0
January 1977 White Paper		100·2	103·0	101·5	101·3
Capital formation, excluding nationalised industries					
January 1975 White Paper	5,713	100·0	101·9	103·1	104·7
February 1976 White Paper		103·3	96·6	92·6	86·9
January 1977 White Paper		105·4	100·8	84·6	79·2
Total expenditure on goods and services					
January 1975 White Paper	29,607	100·0	102·7	104·9	106·6
February 1976 White Paper		101·1	101·2	100·5	99·1
January 1977 White Paper		101·2	102·6	98·2	97·0
Transfers, excluding debt interest					
January 1975 White Paper	18,286	100·0	102·6	105·6	109·6
February 1976 White Paper		100·4	106·5	104·9	104·3
January 1977 White Paper		99·3	103·5	105·7	107·3
Debt interest					
January 1975 White Paper	5,125	100·0	96·9	92·9	90·9
February 1976 White Paper		110·1	136·6	154·1	165·9
January 1977 White Paper		106·8	126·8	142·4	144·4
Financial and asset transactions					
January 1975 White Paper	1,984	100·0	86·6	92·4	100·5
February 1976 White Paper		123·9	104·5	103·5	109·9
January 1977 White Paper		125·3	89·8	51·8	79·8
Total public expenditure, excluding nationalised industries, debt interest and financial transactions					
January 1975 White Paper	47,893	100·0	102·7	105·2	107·7
February 1976 White Paper		100·8	103·2	102·2	101·1
January 1977 White Paper		100·5	102·9	101·1	100·9
Total public expenditure excluding nationalised industries and financial transactions					
January 1975 White Paper	53,018	100·0	102·1	104·0	106·1
February 1976 White Paper		101·7	106·5	107·2	107·3
January 1977 White Paper		101·1	105·2	105·1	105·1
Total public expenditure excluding nationalised industries					
January 1975 White Paper	55,002	100·0	101·6	103·6	105·9
February 1976 White Paper		102·5	106·4	107·1	107·4
January 1977 White Paper		101·9	104.7	103·2	104·2

decline over the preceding four years. The volume of investment, however, remains below the 1976 level in 1981.

The major growth element in public expenditure is spending on welfare benefits – pensions, sickness and unemployment benefit, student grants, for example – which is projected to increase by just over 4 per cent a year on average between 1976 and 1981. There are four principal factors contributing to this increase: the implementation of the child benefit scheme (which is responsible for about half of the increase in total benefits); the assumption that pensions and similar benefits will continue to be uprated with the increase in average earnings (as statutorily required at the

Table 7·A2 Public sector receipts, expenditure and the financial balance at constant employment, 1976 to 1981 (£million at 1976 prices)

	1976	1977	1978	1979	1980	1981
Public sector receipts						
Direct taxes and N.I. contributions:						
on wages and salaries	21,550	21,830	22,660	24,110	25,360	26,660
on other incomes	5,350	5,260	5,860	6,780	6,990	7,280
Total	26,900	27,090	28,520	30,890	32,350	33,940
Indirect taxes less subsidies:						
on consumers' expenditure	6,570	7,010	7,290	7,580	7,880	8,150
(subsidies on cons. expenditure)	2,300	1,880	1,690	1,620	1,540	1,480
local rates	4,460	4,470	4,650	4,750	4,920	5,110
subsidies to public corporations	800	690	590	550	530	510
other net taxes	2,440	2,340	2,710	2,860	3,050	3,270
Total	12,670	13,330	14,070	14,650	15,320	16,010
North Sea revenue	140	320	740	1,350	1,850	2,310
Rent, trading surplus and interest[a]	7,470	7,770	8,240	8,760	9,260	9,700
Total receipts	47,180	48,520	51,570	55,650	58,770	61,970
Public expenditure						
Current expenditure on goods and services	26,440	26,490	26,700	27,490	28,420	29,550
Capital expenditure on goods and services[a]	10,000	8,630	8,300	8,460	8,900	9,430
Current and capital grants:						
welfare benefits[b]	11,000	11,710	12,200	12,620	13,020	13,520
other	3,250	3,600	3,610	3,760	3,920	4,110
Total	14,250	15,310	15,810	16,380	16,940	17,620
Debt interest	5,820	5,780	5,580	5,400	5,130	4,730
Total expenditure	56,510	56,200	56,380	57,720	59,380	61,330
Financial balance, excluding capital taxes and asset transactions	9,330	7,680	4,810	2,070	610	640
Borrowing requirement	10,200	8,030	4,810	2,570	1,030	420
Percentages of GNP at factor cost						
Total receipts	44.5	43·9	44·7	46·2	46·7	47·2
Total expenditure	53·3	50·9	48·9	47·9	47·2	46·7
Financial deficit	8·8	7·0	4·2	1·7	0·5	0·5
Borrowing requirement	*9·6*	*7·3*	*4·2*	*2·1*	*0·8*	*0·3*
Average tax rates: percentages						
Direct taxes on wages and salaries	27·8	28·6	29·3	30·2	30·7	31·1
Direct taxes on property income	15·3	13·0	13·8	15·8	15·8	16·1
Direct taxes on private income	22·6	21·9	22·4	23·6	23·9	24·3
Net taxes on consumers' expenditure	9·8	10·3	10·6	10·4	10·3	10·2
Net taxes on domestic expenditure	9·5	9·7	9·9	9·9	9·9	10·0

Note: The figures may not sum precisely to totals because of rounding.
[a] Excluding stock appreciation.
[b] Social security payments plus student maintenance grants.

moment); the rise in the number of people drawing state pensions, though at a much slower rate than over the recent past (½ to 1 per cent a year, as against an average of 2½ per cent a year over the period 1960 to 1975); and the increase in the number unemployed (of over 300 thousand by 1981) associated with the growth in the labour force and the assumed rundown in temporary employment schemes of various kinds. (This adds about ½ per cent a year to benefits over this period, but is offset to some extent by the gradual elimination of expenditure on short-term measures to alleviate unemployment.)

Finally, grants other than welfare benefits are projected to rise by an average of almost 5 per cent a year, largely as a result of a big increase in contributions to the EEC, which is a prominent feature of the January 1977 White Paper.

The entry for capital expenditure excludes net purchases of land and existing buildings, which is also omitted from the public sector financial balance. Both items therefore differ in this respect from their definition in the official accounts, which unjustifiably – except from the point of view of convenience – include what is essentially a financial transaction, involving no direct addition to the demand on available output, with expenditure on the construction of physical assets. Such purchases are more appropriately treated as equivalent to cash expenditure on company securities which also entails merely a change in the ownership of existing assets.

The financial balance also excludes capital taxes, thereby following the treatment proposed in the 1969 Green Paper (*Cmnd.* 4017) but again differing from that in the official accounts. The argument is that such taxes do not significantly influence private expenditure patterns, insofar as the scale of liability to them and the date of payment cannot be predicted in advance (though it is open to question whether this applies in all cases to capital gains tax).