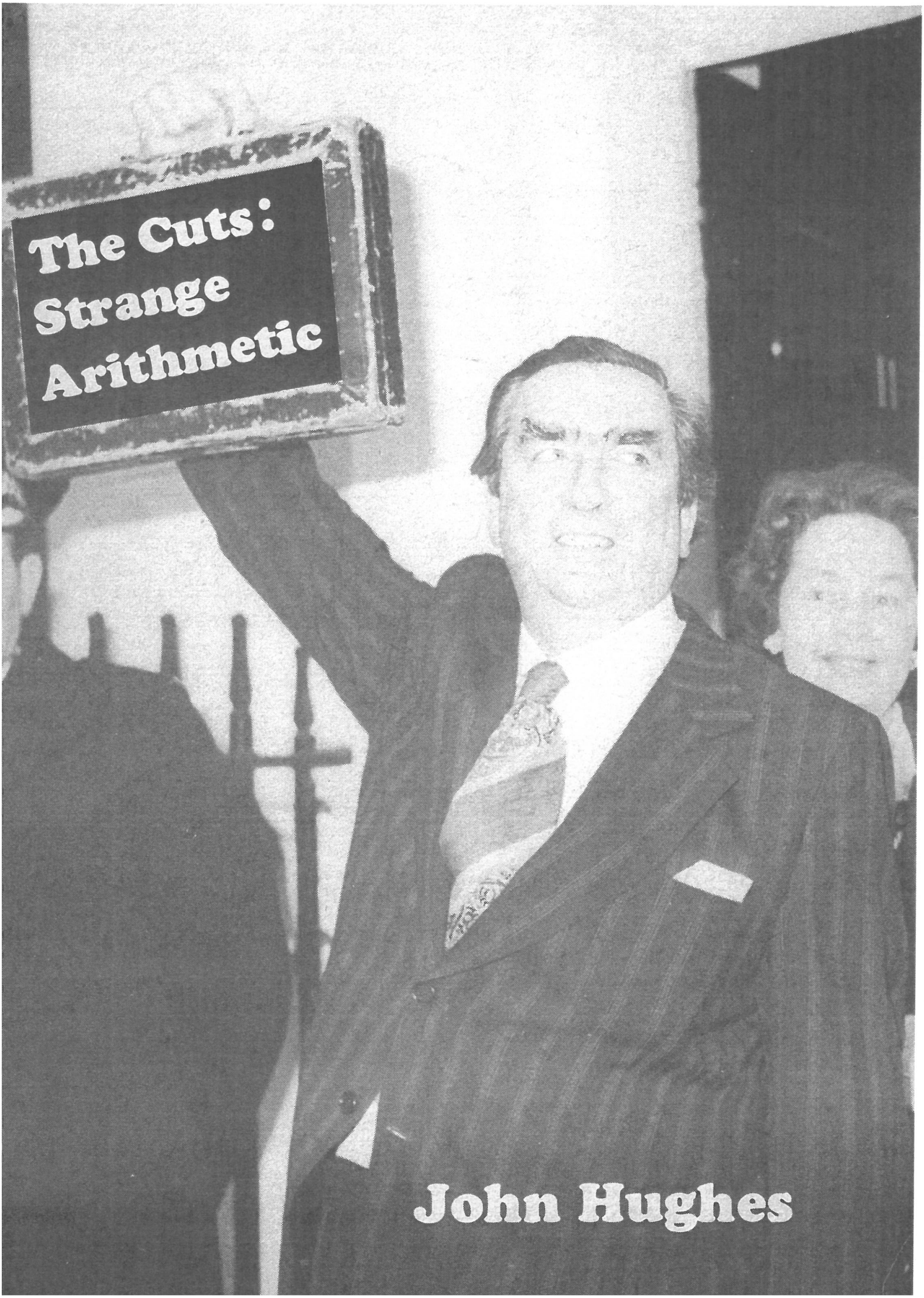
The Cuts:
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John Hughes

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The Cuts: Strange Arithmetic

John Hughes

If there were a prize for the most confusing presentation of public expenditure statistics the British government would certainly win it with its two-volume *The Government's Expenditure Plans, 1978-79 to 1981-82* (Cmnd. 7049 I and II). It may be that the ability to communicate clearly has suddenly deserted the Treasury. Or it may be that it would be awkward to present too starkly and clearly the reality of the recent handling of public spending, and the reality too of the wilful refusal to give increased public expenditure a role in the employment creation that is so patently needed.

Whatever did happen in 1977-78?

If one thing is clear from the new Expenditure White Papers it is that there was a quite staggering under-spending in 1977-78 in relation to the plans that had been drawn up. But that is only *one* part of the story; it is important to recall that the planned spending for 1977-78 (frequently referred to in the White Paper as the plans "in Cmnd. 6721") represented the end of a series of cuts in planned spending. The main points to grasp are these:-

i. The cuts in *planned* spending for 1977-78 came through in two main blocks; the White Paper early in 1976 took about a new £1 billion off earlier plans, and the White Paper in late 1976 took off around £1½ billion. The planned spending in Cmnd. 6721 therefore had already been cut back by over two billion pounds.
ii. The new White Paper shows an "out-turn" of actual expenditure in 1977-78 some £2.4 billion *below* the Cmnd. 6721 plan (this is comparing actual out-turn with the planned total spending of programmes and the "contingency reserve"). There was *also* an under-spending of £600 million on actual as against projected debt interest. So actual expenditure in 1977-78 was almost £5 billion less than the level of expenditure that had originally back in 1975 – been planned. The "under-spend" appears about as important as "the cuts" in earlier programmes in creating that effect.

iii. In reality, the under-spend was more important than the cuts in reducing the level of public expenditure in 1977-78. This is not merely because the total of "cuts" was swollen by the decision to sell off a part of the government's holding of BP (British Petroleum). It is also because the presentation in the new White Paper is of "net" under-spend. During the year 1977-78 government announcements repeatedly *added* to the earlier total of expenditure plans contained in Cmnd. 6721. These announcements[1] added a total of £840 million to planned public expenditure for 1977-78, that is an amount in excess of the "contingency reserve". The extraordinary aspect of this is that through repeated announcements of additional expenditure the government gave an impression of public spending being increased during 1977-78 while in fact it was going rapidly downhill. In the end the new White Paper can be made to reveal (but the reader has to work on Table 13 and 14 as well as Tables 1 and 2 of the White Paper)*that although the government *ostensibly raised* its planned expenditure for 1977-78 by £840 million the actual out-turn was *£2½ billion less* than this revised total.

iv. How big was the "under-spend" in relation to total programmes? The best answer would would appear to be 4.4%. This is the estimated actual out-turn spending on all programmes (but leaving aside the saving of debt interest) compared with the earlier plan plus the subsequent announcements of a further £840 million for 1977-78.[2] It does not seem possible to allocate the under-spending more closely to the main categories of spending, since the additional £840 million is not so allocated, and comparing sub-totals of actual spending with the original provision in Cmnd. 6721 would be somewhat misleading. The under-spending was large in 1976-77 also: Table 13 of the White Paper estimates it at £2.4 billion (at 1977 prices) – virtually as large as in 1977-78. It is in fact highly significant that such a high and persistent level of under-spending should be emerging. In paragraph 15 of Volume I the government advances three main reasons:-

a. The use of cash limits: "programme managers were especially careful to run no risk of exceeding their limits";
b. Prices rose faster than had been allowed for when the cash limits were set (note that the cash limits were not revised upwards on this account) so that the "real" or "volume" expenditure fell even further below the programmes;
c. There were delays in some expenditure programmes – significantly, new measures to promote employment turned out less than the original estimate.

These persistent factors should be borne in mind since the estimates for the coming fiscal year may well be afflicted with the same set of considerations.

v. How significant was this under-spending in terms of the total national income, and in terms of employment and other effects in the national economy?

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* These tables are reproduced on pages 7, 8 and 9.

Understandably, the White Paper does not offer any estimates. But the shortfall can be reasonably put at around 2% of the gross domestic product in both 1976-77 and in 1977-78. In equally round terms this might be expected to involve something like 400,000 fewer people in employment after an interval of time (say by the winter of 1976-77); the downward "multiplier" effects would increase this figure to over 500,000 by the winter of 1977-78. In terms of registered unemployment this might be translated into at least 250,000 additional unemployed in the winter of 1976-77 rising to a third of a million or more by winter 1977-78. In case these figures seem excessive, it should be recognised that *if there had been no underspend* the likely growth of the economy would have been around 3% in both 1976 and 1977 instead of the dismal 2% and less than 1% that actually occurred. If the Treasury do not like these outline figures they must do what they have not done in the White Paper, that is, demonstrate (if they can) that not all the under-spend can be translated into a decline in actual levels of demand for resources in the economy. We must again emphasise that these figures do not take into account the depressive effect on demand from direct cuts in expenditure programmes. If these are also taken into account, then the out-turn of public expenditure in fiscal 1977-78 turns out in total to be 8% or more below the original expenditure programmes (pre-cuts; assuming no under-spend); this means a cut in relation to gross domestic product in 1977-78 of over 3%, probably nearer 4% even without allowing for "multiplier" effects. The impact of this on employment must be put even higher than the 500,000 estimated above; probably the effect on registered unemployment is in the 400,000 to 500,000 region. Again, if this seems surprising it should be remembered that 1977 was a year of rapid increase in export volume, and moderate increases in private sector fixed capital formation; it was only savage reductions in public expenditure that could connect what we have always been told were key requirements for sustained growth of the economy to an actual "achievement" of less than 1% growth and a renewed increase in unemployment. To put it another way, without the public expenditure cuts and the associated under-spend, the national economy would now have only around one million unemployed compared with a level close to a million and a half.

vi. So how far did *actual* public expenditure fall in 1977? The previous discussion has compared actual spending with earlier "plans", but what was the year to year movement of actual spending in real terms? At constant (1977) survey prices the new White Paper estimates a decrease of nearly 7% in total expenditure on the various programmes in the two years to 1977-78. The decline was apparently one of just over 3½% in the year to 1976-1977 and just under 3½% in the year from then until 1977-78. The direct scale of this is equivalent to a decline each year of 1½% in gross domestic product, but this ignores multiplier effects which would further increase the depressive effect. Clearly, by 1977-78 the result was enough to generate by itself a decline of around 2% in the annual gross domestic product of the country. The combined effect over the two years might again be calculated as sufficient to generate a rise of 400,000 or more in the level of unemployment. It should be recognised that the scale of the fall in public expenditure on public services, and on capital spending, can be presumed to be greater than the overall rate of decline; for the cuts in spending by generating increased unemployment lead to increased social security expenditure.

Within the overall decline it is important to notice the savage decline in capital expenditure. Overall "gross domestic capital formation" in public sector programmes fell by nearly £2 billion (1977 prices) in two years, *a fall of 27%.* In the single year from 1976-77 to 1977-78 the fall has been one of 19%. Coming from an economy that had produced 1.3 million unemployed in 1976-77 this is not merely an abandonment of Keynesian fiscal policies, but the kind of irrational anti-Keynesianism that must have the author of the *General Theory of Employment* turning in his grave. Within the total perhaps the most astonishing decline in spending on capital was concentrated in Local Authorities' programmes in England and Wales. In the three years to 1977-78 capital expenditure fell by £1,800 million, a fall of 46%; in the last year alone there was a decline of over £800 million in such spending, a fall of one quarter.

(Perhaps neither Mr Healey nor his Treasury advisers still read Keynes' *Essays in Persuasion:*

> "The Government's programme is as foolish as it is wrong. Its direct effect on employment must be disastrous . . . It represents a reckless reversal of all the partial attempts which have been made hitherto to mitigate the consequences of the collapse of private investment . . . Not only is purchasing power to be curtailed, but road-building, housing, and the like are to be retrenched. Local authorities are to follow suit . . ."
>
> "If we carry 'Economy' of every kind to its logical conclusion we shall find we have balanced the Budget at nought on both sides, with all of us flat on our backs starving to death from a refusal for reasons of economy, to buy one another's services . . . "
>
> "What are we releasing resources for today? To stand at street corners and draw the dole." [pp.164-165, and 281].)

vii. But perhaps all this is behind us and we can now find in the new White Paper adequate provision for a balanced expansion of public expenditure that will – even if belatedly – make its major contribution to the creation of jobs? It does not appear so.

Those who have not yet become used to the "double-think" of the new White Paper might initially think that renewed expansion of spending on current and capital goods and services was being provided for. On closer examination this prospect fades. The Treasury provide us with two estimates; one (Table 8) indicates less than a 1% increase in 1978-79 on "expenditure on goods and services"; the other (Table 10) projects a rise of around 1.85% (made up of a 1.3% rise in spending on wages and salaries – at constant 1977 prices – and in current goods and services, and a rise of just under 5% in gross fixed capital formation). But as paragraph 21 somewhat obscurely points out the "likelihood" of continued "shortfall" is "taken into account" in the estimates for the economy. And sure enough, in Table 8 (but not in Table 10) there is an estimated £1 billion shortfall.[3] This we are told is "only a very broad judgement about the possible outcome". But as such it appears to be anticipating something of the order of a 3% shortfall (if it is concentrated on the actual spending on goods and services); even if this were scaled down to the 2%

under-spend which appears to be the concomitant of cash limits so far, it offers us sad tidings. For applying that to the "plans" for 1978-79 suggests that a slight *fall* in *actual* spending on goods and services is in prospect, by comparison with the actual 1977-78 level.

The government having dug a big hole in the economy seems to be proposing to leave it there. This is very obvious in the forward "plans" for capital investment all the way through to 1981. Thus, the capital spending of Local Authorities in England and Wales is planned barely to rise at all, and by 1980 and 1981, still to be only 60% of its 1974-75 level. Over the whole range of public capital spending the plans only provide for a rise from 1977-78's 73% of the 1975-76 level to around 77% by the early 1980s. What kind of policy is it that can "plan" to maintain the 25% or so cut in public capital spending for the whole of the second half of the decade of the 1970s? Or to expect us to disconnect that in our minds from the persistence of mass unemployment?

Perhaps some supporter of the government will point out that the government is planning an increase in spending on grants – particularly "to persons" and "abroad" in 1978-79. Most of the increase in grants "abroad" is taken up by increased contributions to the European Community. As to grants to persons the bright spot is provided by the increase in child benefits. Somewhat less bright is the "planned" increase in expenditure on unemployment benefit (at constant prices more than double the 1974-75 level), and pointing to a government expectation of an average unemployment level in 1978-79 even higher than in 1977-78. However, the Treasury is modest about this aspect of its projection; the figures for unemployment benefit (which point to an assumed total of around 1½ million registered unemployed, only a proportion of whom actually receive benefit) "represent a working assumption and not a forecast of unemployment levels . . ."

But was it unavoidable?

However, it might be argued that tragic as this survey of public expenditure has been, it was the necessary price for "sound" management of the economy. In earlier years we heard much of the "crowding out" of private sector use of resources by increased public sector claims on them. We heard too of the alleged dangers of high levels of public sector financing deficits for management of the monetary system.

At almost the same time as the White Paper on *The Government's Expenditure Plans* the OECD has published its December 1977 edition of *Economic Outlook*. This has a very interesting, if guardedly written, "special section" on "Public Sector Indebtedness and Government Financing". What it shows is that the UK was not alone in the increase in its financing deficit (as measured by the public sector borrowing requirement) between the boom of 1973 and the recession of 1975; the increase in the deficit was about the same – measured as a proportion of Gross Domestic Product – in the USA, in Japan and in Germany (an increase of around 5% of GDP). Since 1975 both Britain and Germany emerge as countries that hastened to curtail their public sector deficits (and in both slow growth and rising unemployment are to be observed), whereas the United States and Japan show a more modest reversal of their public sector financial deficits. But in none of the countries studied[4] was there a "crowding out" problem or any major difficulty in financing the deficit:-

> "The financing of increased public sector indebtedness has been made relatively easy in recent years by the concomitant cyclical weakness in private sector demands for credit. Since the total supply of credit market funds available for meeting private and public sector demands has remained stable or even increased, there was little internal pressure on interest rates."(OECD. *Economic Outlook,* December 1977, p.43.).

Nor did any serious problems emerge in the handling of the public debt: "the monetisation of government debt was well contained in all countries considered, and tendencies towards shortening maturity structures of outstanding government debt were quickly reversed". And the OECD goes on to give a small but distinct cheer for Keynesian fiscal policy (having shown that the orthodox monetarist fears of deficit financing had not been borne out):-

> "Present levels of public indebtness and government financing needs as such do not appear, on purely economic grounds, to stand in the way of employment-supporting fiscal policies in the largest OECD economies." *(Op.cit.,* page 46).

It is a sad comment on the Government's White Paper on its expenditure plans that it does not yet seem to have moved even as far as the OECD has back to a cautious acceptance of Keynesian fiscal logic. Meanwhile, as Keynes said, policies of cutting expenditure and balancing budgets in a period of recession mean that resources are "released" . . . "to stand at street corners and draw the dole". The legacy of the lurch back to pre-Keynesian Treasury orthodoxies since 1975 is there not only in reduced public services, unkempt and obsolete public buildings, and potholes in the roads, but in an additional half a million or so unemployed workers.

FOOTNOTES

1. Announced changes in expenditure for 1977-78 (after Cmnd. 6721):-

March	+	£81 million
May	+	£46 million
June	+	£46 million
July	+	£255 million
Oct.	+	£100 million

   Other announcements + £255 million. Total £840 million.
2. The White Paper seems to prefer to compare actual 1977-78 spending with the earlier plan (Cmnd. 6721) plus the contingency reserve in that plan. On this basis the under-spend was 4¼%, although Para.17 of Vol.I of the White Paper mistakenly puts it at 4½%, or "about 95½%".
3. In case any readers might actually grasp the point, the White Paper has a footnote to its Table 8 on the "shortfall" directing the reader to a subsequent paragraph 63. This is a mistake for paragraph 60.
4. United States, Japan, W. Germany, France, the UK.

Tables extracted from *The Governments' Expenditure Plans, 1978-79 to 1981-82*

Table 1: Public Expenditure plans

£ million at 1977 survey prices

	1977-78 as in Cmnd 6721	*1978-79*	*1979-80*	*1980-81*	*1981-82*
Expenditure on programmes:					
Central government	39,572	41,655	41,980	42,418	42,570
Local authorities	15,407	15,493	15,719	15,890	15,992
Total general government	54,979	57,148	57,699	58,308	58,562
Certain public corporations	993	952	1,012	1,002	1,015
Total expenditure on programmes	55,972	58,100	58,711	59,310	59,577
Contingency reserve	750	750	1,500	1,750	2,000
Total	56,722	58,850	60,211	61,060	61,577
Debt interest	2,500	2,000	1,900	1,800	1,600
Total public expenditure	59,222	60,850	62,111	62,860	63,177
Total programmes, contingency reserve and net overseas and market borrowing of nationalise industries	57,267	58,550	59,611	60,860	61,327

1. Corporations whose capital expenditure is included in public expenditure; mainly the water authorities, the housing corporation and the new town development corporations. These corporations do not include the nationalised industries.

Table 2: Public Expenditure 1974-75 to 1977-78

£ million at 1977 survey prices

	1974-75	*1975-76*	*1976-77*	*1977-78 estimated*
Expenditure on programmes:				
Central government	39,661	40,279	39,238	38,233
Local authorities	16,931	16,846	15,916	15,165
Total general government	56,592	57,125	55,154	53,398
Certain public corporations	1,138	1,176	1,047	922
Total expenditure on programmes	57,729	58,301	56,201	54,320
Debt interest	907	1,169	1,662	1,900
Total public expenditure	58,636	59,470	57,863	56,220
Total programmes and net overseas and market borrowing of nationalised industries	58,742	59,077	57,635	54,739

1. See note 1 to table 1.

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