

PUBLIC SECTOR POLICY GROUP

Submission to the Shadow Cabinet by the
Public Sector Policy Group

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PUBLIC EXPENDITURE

The Public Sector Policy Group has examined the trends in public spending, the problems of controlling it, and the scale of reductions which need to be made to total expenditure in the period ahead. Our conclusions are set out below. We would ask members of the Shadow Cabinet to study the Appendices for more detailed analysis and argument.

WHAT IS HAPPENING

1. This financial year, public spending is likely to be at least £20 billion higher in money terms than in 1973/74. The increase in real terms over what had been projected by the last Conservative government before it left office is about £4 billion - more than the entire defence budget and about equal to the health and social services budget (£3,860 million).
2. Looked at from the viewpoint of the public sector borrowing requirement (now estimated at £12½ billion), the percentage of GDP devoted to public spending (56 per cent now as against 50 per cent in 1971), manpower in the public sector (over 500,000 more people are employed than in 1971) or the allocation of resources, it is clear that current trends are leading to a disaster. Appendix 1 goes into more details and explains why.

REDUCTIONS NEEDED

We consider it essential to give members of the Shadow Cabinet an idea of the dimensions of the problem facing us in quantitative terms, despite the considerable difficulties of estimating future public spending.

1. In order to avoid the acute inflationary dangers which arise from a borrowing requirement at present levels, we believe that the PSBR must be reduced by about £3 billion a year between now and 1978 (see Appendix 2). To a major extent this must be achieved in the short term, by cuts in transfer payments.
2. We believe that on an assumption of 2 per cent average annual growth of GNP and a 1 per cent growth in personal consumption - our own "resources" table is in Appendix 3 - there must be a shift of resources from the public to the private sector of £6½ billion at 1975 prices and in demand terms by 1979. This will need to be achieved over a period to avoid unacceptable repercussions on the level of economic activity and employment.

METHODS PROPOSED

The Group agrees that the overriding need is for an exercise of political will. No reduction will in practice be made unless

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it engages the complete commitment of the P.M. and her closest and most powerful political colleagues.

We believe it necessary that there must be more than one strong departmental voice in favour of lower public spending both in Cabinet and Cabinet committees.

We have yet to consider in detail a suggestion that this might be achieved by creating a separate Ministry of the Budget. As an alternative there might be a new "inner" Cabinet committee containing the most powerful three/four members of the Cabinet who would be sufficiently aware of the economic realities to support Treasury Ministers at all points and in all gatherings where spending decisions are taken.

One way or another the departmental balance between spending Ministers and Ministers committed departmentally to reduce public spending must be changed substantially in favour of the latter.

Assuming the will exists on the part of the Shadow Cabinet we believe that it must be supported by the following tools:

(a) Cash ceilings - to be used not just as a means of controlling existing programmes but an internal mechanism for forcing reductions in spending. We appreciate the major difficulties and complications of this area but it is essential to have public sector accounting principles which force Ministers, councillors and officials to take the necessary ugly decisions where money limits are exceeded. Cash ceilings are not a panacea but they are a necessary discipline.

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(b) Manpower ceilings - detailed proposals are set out in Professor Merrett's paper which put forward proposals for a nil replacement programme in the public sector (equal to a 5 per cent reduction in numbers over at least 4 years). If the objectives were met there would be a reduction in employment in the public sector of 500,000 over a four-year period, saving £2.5 billion in public expenditure.

(c) The elimination of functions in every department. Proposals must come from other policy groups but the Public Sector Policy Group will be making recommendations after the recess.

(d) Efficiency and cost cutting - there must be a more rigorous and systematic questioning of programmes and tighter management control.

IMPLICATIONS FOR SECTORAL BUDGETS: AN ILLUSTRATION

There are three main elements to public spending:

- (1) Transfer payments
- (2) Current expenditure on goods and services
- (3) Capital expenditure

We believe that capital expenditure programmes have already been sharply pruned with adverse consequences for employment in the private sector and the future infrastructure of the country. Further reductions should be avoided in this area. In the

immediate future we look primarily to transfer payments for new savings, even though the medium-term objective must be to shift real resources from the public sector to the private sector as fast as possible without creating intolerable unemployment.

To establish the scale of the reductions required in current conditions we put forward the following figures for reductions in year 1. Spending departments will be able to gauge the functions which will need to be eliminated to meet the figures below on a current basis. It should be emphasised that these figures are illustrative of the scale of reductions required and do not represent our view as to what the priorities should be. This is clearly a matter for the Shadow Cabinet. The figures for cuts in expenditure on goods and services have been arrived at simply by assuming that cuts would be made across the board on a proportionate basis (i.e. so that existing relativities between sectoral budgets in relation to the total expenditure on goods and services are preserved).

Reductions in public expenditure 1975/76 in 1974 Survey Prices
(based on the January 1975 public expenditure White Paper, Cmnd. 5879

	Transfer payments reductions required on Cmnd. 5879	Reductions in expenditure of goods & services required on Cmnd. 5879
£ million		
Defence		127
Overseas affairs		6
Agriculture, Fish, Forestry (food subsidies)	488	4
Trade, Industry, Employment		16
Nationalised industry (price restraint)	250	75
Roads and Transport	251 *	44
Other Environmental Services		50
Law and Order		38
Education		128
Health & Personal Social Services		138
Social Security		10
Other Public Services		17
Common Services		18
Housing	715	62
Northern Ireland		20
	1,704	753

* The break-down of the figure is as follows:

British rail subsidy	98 m.
Port subsidies	21 m.
Passenger Transport subsidies	100 m.
Bus Fuel grants	32 m.
	251 m.

The above figures are in 1974 Survey Prices and represent a reduction on those given in Tables 1.2 and 1.3 of the 1975 Public Expenditure White Paper (Cmd. 5879). The total of £2,457 m. is equivalent to £3,000 m. in current prices.

The Shadow Cabinet should also note the following points:

1. The effects of reducing transfer payment by £1,700 m. would clearly be to increase the retail price index. Quite what the effect would be is extremely difficult to estimate. The only reasonably sure estimate is that the removal of food subsidies would put 1½ - 2 per cent on the retail price index.
2. The above reductions in transfer payments would have an impact on employment in the private sector as a result of a dampening of demand.
3. The illustrative figure of £3 bn. (in 1974 survey prices) is before providing any funds for the protection of low income families. Since the proposals envisage a cut in housing subsidies by over a half - they are currently running at £1,200 m. - and the virtual elimination of food subsidies, it would be necessary to find additional offsetting reductions to meet this need.
4. In order to achieve the switch in real resources which is so necessary for the economy, the size of the reductions falling on real resources employed in the public sector over the period up to 1979 will have to be at least 9 times the illustrative figure of £753 m. given for 1975/76 (i.e. to reach the target of £6.5 bn).

Decisions Required

1. Approval by the Shadow Cabinet of the general approach adopted in this paper and recognition that this has major implications for policy work - and policy statements - across the board.
2. Agreement that after the recess the Public Sector Policy Group should proceed to a detailed scrutiny of departmental budgets, with a view to determining how the above targets (or alternative targets agreed by the Shadow Cabinet) can be met and that this should be done in close conjunction with other Policy Groups. (The Group would, for example, envisage a number of meetings with Chairmen and members of other Policy Groups to discuss levels of expenditure within their spheres of interest.)
3. Agreement that the Public Sector Policy Group should examine more closely the methods and machinery needed for effective control of public expenditure and report to the Shadow Cabinet.

The Shadow Cabinet are invited to study the more detailed work set out in the attached papers.

JOHN NOTT
Chairman

PUBLIC SECTOR POLICY GROUP

APPENDICES

- Appendix 1 Trends in government spending
- Appendix 2 Establishing a target for the reduction in the public sector borrowing requirement (PSBR)
- Appendix 3 Resources
- Appendix 4 Professor Merrett's paper on manpower control

Members of the Shadow Cabinet are reminded that they have recently received from Sir Geoffrey Howe a note on public spending (LCC/75/81) with an attached speech by Sir Geoffrey - this sets out the main reasons why we must aim for a substantial reduction in public expenditure in the period ahead.

The following gives an idea of what has been happening to public expenditure in recent months:

According to the Government's supply estimates for 1975/76, total public spending this year (1975/76) will be £53.5 billion. This is £20 billion above the level of expenditure in 1973/74. This means an increase of 21.4 per cent over 1974/75 and 60.5 per cent over 1973/74. But even this could be a serious underestimate. Indeed if the difference between forecast and outturn for the present financial year is proportionately as great as it was in the financial year 1974/75, total public expenditure could exceed £60 billion in cash terms this year.

Last financial year public expenditure increased in real terms by some £5 billion over the previous year. If one compares the public expenditure outturn in real terms in 1974/75 with the last projections left by the Conservative Government (i.e. taking into account the Barber cuts in December 1973) the difference is a figure of about £4000 million. This is larger than the entire defence budget (£3,533 billion in 1974/75) and roughly equal to the health and personal social services budget (£3,860 million).

Public spending in real terms, including RPE

The table below shows the percentage growth in public expenditure at factor cost comparing it with the growth of GNP at factor cost.

	1970-71 over 1969-70	1971-72 over 1970-71	1972-73 over 1971-72	1973-74 over 1972-73	1974-75 over 1973-74	average rate of growth
% increase in expenditure at 1974-75 out- turn prices including RPE	2.9	1.5	5.3	9.9	12.5	6.4
% real increase in GDP at factor cost	1.8	1.3	4.3	2.4	2.1	2.4

(Source: Cmnd. 5879, PSBR & CSO)

There is no official estimate of the real increase in public sector spending in 1975/76 over 1974/75, the Treasury being unwilling to commit itself to a forecast of the rate of inflation in the current financial year. The National Institute however, forecasts an increase in real terms of 3.3 per cent. Though this is a considerable reduction over last year's increase, it is still above the annual average rate of increase provided for in the 1975 White Paper and quite out of line with what is likely to happen to the gross national product this year.

Public spending as a percentage of GNP

Public expenditure has grown at a considerably faster rate than total economic resources and has therefore increased its share of GNP. This increase was particularly sharp between 1973-74 and 1974-75.

Total public expenditure as a percentage of GNP at current factor cost

1971/72	1972/73	1973/74	1974/75
50.0%	49.7%	52.6%	56.0%

(Source: Financial Statistics, Monthly Digest of Statistics, NEQB)

1976/77 and beyond

To forecast the size of public sector spending for the next financial year and beyond is extremely difficult. In his April 1975 Budget the Chancellor announced cuts in spending in 1976/77 of £900 million (at 1974 survey prices). On the basis of the projections in the public expenditure White Paper this would reduce public spending by 1.3 per cent in real terms in 1976/77. However, it is highly questionable whether this is likely to happen. The proposed cuts could very easily be swamped by unplanned increases in real expenditure of the kind that occurred in 1974/75 and are also likely to be revealed for this financial year. The two statistical annexes contain further information about recent trends in government expenditure.

Estimate of the Reduction Needed

We are making the assumption in this paper that there is broad agreement in the Conservative Party that the share of national resources which is currently being devoted to public expenditure is excessive and needs to be reduced. As well as the broad political reasons for holding this view, there are a number of imperative economic considerations.

- (i) Unless there are to be swingeing increases in taxation, government spending at the present level must mean a dangerously high level of government borrowing, with the attendant risk that inflation will be stoked by an excessive increase in the money supply (i.e. "printing money").
- (ii) The inflationary spiral could be given a further twist by the popular reaction against the excessive squeeze on personal consumption which is implied by the government pre-emption of real resources.
- (iii) Insufficient room is left in the economy for the expansion of exports and investment and this is obviously extremely damaging for longer-term prosperity. What is needed is nothing less than a major transfer of resources from the public sector into the company sector - a transfer which one would obviously want to achieve with the minimum of adverse consequences for employment in the short run.
- (iv) An increasingly weak productive section of the economy has to carry the burden of a growing public sector, with adverse consequences for Britain's ability to pay her way in the world.

- (v) Very high levels of employment in the public sector automatically generate demands for its own enlargement and for supporting expenditures.

Here it can be pointed out that the situation is made more difficult by the poor growth prospects for the economy in the immediate future. The White Paper on public expenditure published by the Government in January (Cmd. 5879) bases its projections on three assumptions about the annual average rate of growth between 1973 and 1978/79, namely 2½%, 3% and 3½%. In our view these assumptions are too optimistic and our own estimates of the growth and allocation of resources, set out in detail in appendix 3 assume a substantially lower growth rate.

Against the background of the above considerations the Public Sector Policy Group has endeavoured to arrive at a view of the parameters for public sector spending in the period ahead. It has adopted two avenues of approach: (1) the establishment of a reasonable target for reducing the borrowing requirement; (2) by considering the likely growth of resources and how they should be divided as between personal consumption, investment, exports and the public sector. In this approach we have chosen to reverse the procedure which was followed in the 1975 White Paper on public expenditure; i.e. instead of giving the public sector the first call on resources available for domestic use, however small these may be, the demands of the public sector would be linked to the rate of growth in the economy and after taking into account the reasonable demands of all other sectors, including private spending.

The detailed workings of these approaches are set out in appendices 2 and 3 and the conclusions are summarised in the main paper.

STATISTICAL APPENDIX

Public expenditure from 1969/70 to 1975/76

	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76 (estimate)
<u>Total</u>							
Volume (1974/75 £m autumn prices inc. RPE)	32,494	33,447	33,951	35,740	39,261	44,151*	43,404*
% change on previous year	-	2.9	1.5	5.3	9.9	12.5	No true constant price comparison available.
<u>Total</u>							
Current prices	20,134	22,593	25,070	28,577	33,922	44,151*	53,588*
% change on previous year	-	12.2	10.9	13.9	18.7	30.2	21.4
<u>Goods & Services</u>							
Current prices £m	11,696	13,698	15,266	16,958	19,792	25,325*	30,769*
% change on previous year	-	14.4	11.4	11.1	16.7	27.9	21.5
<u>Transfer payments</u>							
Current prices £m	7,136	8,729	10,558	11,411	13,988	18,826*	22,819*
% change on previous year	-	22.3	20.9	8.1	22.6	34.6	21.2

(Source: Cmnd. 5879) -

* From 1975 FSBR

From White Paper on public expenditure, January 1975, Cmnd. 5879

Public Expenditure (by programme)

The following table shows the real percentage rise in public expenditure of goods and services (GS) and transfer payments (TP) in 1974/75 over 1973/74. Also shown are the estimates for the percentage rise in central programmes which are estimated to occur in 1975/76 over 1974/75. These percentage figures can be read in conjunction with the aggregate figures for spending which have been taken from the 1975 White Paper and are attached.

		1974/75 over 1973/74 (real % rise)	1975/76 over 1974/75 (money % rise)
1.	Defence	GS - 1.9%	6.6%
		TP 12.5	
2.	Overseas services	GS 8.2	3.3
		TP 20.0	
3.	Agriculture	GS - 8.0	11.4
		TP 134.5	
4.	Trade, Industry, Employment	GS 14.1	8.3
		TP 10.5	
5.	Nationalised industries' investment	GS 11.9	-
		TP -	
6.	Roads & transport	GS - 4.7	- 0.2
		TP 75.4	
7.	Housing	GS 24.1	5.3
		TP 39.9	
8.	Other environmental services	GS - 7.3	15.4
		TP 27.5	
9.	Law & order	GS 3.3	15.1
		TP -	
10.	Education, libraries, etc.	GS 2.1	11.5
		TP - 2.5	
11.	Health	GS 1.9	9.1
		TP 10.7	
12.	Social security	GS 7.8	26.4
		TP 6.2	
13.	Other public services	GS 6.9	18.8
		TP - 3.4	
14.	Common services	GS 3.1	0.2
15.	N. Ireland	GS 16.1	8.5
		TP 25.7	

(Source: Cmnd. 5879, FSBR)

In any mature economy it is normal to find a difference between the spending requirements and income of each of the four major sectors of which it is composed - Companies, Persons, Government and Overseas. Necessarily, the surpluses and deficits of the four sectors, commonly known as the "flow of funds" must net out ex post facto. However, their plans and expectations may initially be inconsistent. If the inconsistencies are at all substantial their reconciliation can have harmful consequences. For example if companies cannot borrow as much money as they plan to, then they will have to cut their spending on investment in machinery and stocks and reduce their labour force. If, in particular, Government plans to borrow more money than can be lent to it by the rest of the economy then it will be faced with two choices: to have recourse to the printing press; or by some means or other to divert to itself the surpluses which other Sectors need to finance their activities on a proper scale. The first course of action threatens inflation, the second deflation, recession and numerous damaging tensions in the economy.

Our long-term programme for control of public expenditure must therefore satisfy two conditions:

- (i) that the lending and borrowing figures implied for each of the four sectors are consistent with one another;
- (ii) that the figures implied are consistent with a healthy balance of payments, the recovery of the company sector and a realistic level of personal saving.

We can derive from the above a flow of funds target for a terminal year (which we have assumed to be 1978). However, in order to establish a target for reducing the public sector borrowing requirement (PSBR) financial transactions have already been taken into account - the PSBR is the sum of the public sector's net financial deficit.

The only simple way in which it is possible to indicate a suitable programme for the "domestication" of the PSBR is to compare the position expected this year (in as far as it can be guessed at) with what might be considered a desirable target situation in a terminal year. This is set out in the table below where Cols. 1-4 set out the central surplus/deficit which set sums to zero - Col. 5 sets out the Government financial transactions, and Col. 6 gives the Government's total (i.e. gross) borrowing requirement.

Deficits, Surpluses & the Public Sector Borrowing Requirement
1975 and 1978 £ Billion 1975 prices

Sector:	Overseas	Persons	Companies	Public	Financial Transactions	Public sector Borrowing Requirement = 4+5
1975	+2	8½	0	-10½	-2	-12½
1978	0	3	0	-3	-1	-4
Desired change				+7½	+1	+8½

The implication of these calculations and assumptions is that the PSBR should be reduced from £12½ b. this year to £4 b. in 1978, a reduction of a little less than £3 b. a year. These estimates rest on a number of important but necessarily tentative assumptions:

Col. 1 Overseas Sector: the deficit (i.e. overseas sector surplus) is expected to deteriorate sharply later in the year and give a full year outcome for 1975 quite close to that expected by reputable forecasters. Errors in this figure do not matter much, since they would not have much effect on the expected public sector deficit which is what matters in the present context. The target for 1978 is taken to be a balanced position in 1975 prices.

Col. 2 Persons: The enormous personal sector surplus of £8½ b. for 1978 is the figure implied by accepting the targets or forecasts for other sectors. The 1978 target represents a very rough guess at the maximum surplus one could reasonably expect and desire persons to generate under normal circumstances.

Col. 3 Companies: The 1975 figure is a guess at this year's likely outcome, reflecting above all the combined effect of destroying lower investment and the Chancellor's tax reliefs. That for 1978 is a (highly debatable) target.

Col. 4 Public Sector: The 1975 figure is a guess about what would be likely to happen on present policies, assuming no further increase in the rate of inflation. The 1978 figure is the residual dictated by the figures put in for the other three sectors.

Col. 5 Financial Transactions: For this year it is assumed that financial transactions will cost about £500 million more than allowed for in the Budget, principally because of under-estimation of the costs of Bannery and nationalisation. The 1978 target is the most arbitrary figure in the table, essentially embodying a political judgement that the undesirable transactions which inflate the current figure should be cut back to an absolute minimum. As a share of government the £1 b. deficit suggested is considerably lower than that experienced in most years since the war and may, on further investigation, turn out to be too stringent.

Table 3 is our alternative to the Growth and Use of Resources table in the January 1975 White Paper (Cmd. 5879). The following can be noted regarding assumptions and caveats:

(a) As can be seen we have postulated growth rates of 1%, 2% and 2½% in contrast to the White Paper which worked on growth assumptions of 2½%, 3% and 3½%. We believe there are a number of reasons for being less optimistic about growth than the White Paper is.

(b) Our 2% growth assumption is the one we think the most realistic. We have included Cases A and B not because we think that 1 per cent average annual growth rate is a likely eventuality but because it can help underline the implications for government spending of a stagnant or near stagnant situation in the domestic economy.

(c) The assumptions we have made about the resources going in to improve the trade balance are necessarily rather arbitrary - we have varied this assumption according to the growth rate. However, we have kept the assumption about private investment constant. This represents our view of the minimum level of investment necessary to safeguard the economy's future. The assumptions about nationalised industries' investment and public investment are those of the White Paper.

(d) Explanation of Tables 3 and 4

Table 3 assigns the necessary resources to trade, investment and personal consumption (which is assumed to grow at 1% and 2% for each GDP growth assumption) and then treats public consumption as a residual. In most cases this implies falling public expenditure in real terms.

Table 4 takes each case in table 3, adding 1975 prices, and compares the position where we should now be (according to table 3) with the position at which we think we are. Lines (1) and (2) of table 4 give our estimate of what has occurred up to 1975, and line (3) projects growth from 1973 on the assumptions of the White Paper.

(e) The extreme uncertainty of all the figures in our tables should be stressed. The Relative Price Effect (RPE) has been taken into account in our estimates of the years up to 1975, but thereafter no account has been taken of it. No reliable estimate can be made of the real growth in expenditure between 1974 and 1975, because the Treasury cannot commit itself to a rate of inflation. The estimate we have made is that no real growth is anticipated, but this is based on little more than a hint in the obscure statistical literature on this subject. In any case, the Treasury has failed so badly to hit its targets in the past year that any estimate is likely to prove wrong. We have converted 1970 prices into 1975 prices by doubling them - this is the extent by which the index of public expenditure rose, plus our own estimate for 1975. It should be emphasised that all the figures in tables 3 and 4 are in demand terms and therefore not strictly comparable with many other sources of public expenditure figures, such as Red Books, which use market

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price rather than factor cost figures and need to be converted into demand terms. However, the figures in line (3) of table 4 are roughly comparable to those in table 3 and lines (4) to (9) of table 4.

(F) Observations. The cases which deserve most attention are those in lines (6), (8) and (9) which refer to cases c, e and f.

In case c (line 6) we assume 2 per cent growth and growth of 1 per cent in personal consumption: if we were to be properly on course to achieve this, public expenditure in 1975 would be £4,750 m. (at 1975 prices and in demand terms) below its present level and £3,044 m. and £6,550 m. below the Cmd. 5779 levels for 1976 and 1977 respectively. Similarly in cases E and F in lines (8) and (9), the following cuts would be required:

Case E:

1975 - £3,170 m.	}
1976 - £1,224 m.	
1979 - £2,610 m.	

Case F:

1975 - £6,750 m.	}
1976 - £6,684 m.	
1979 - £12,950 m.	

See tables 3 and 4 overleaf.

Table 3

Growth and Use of Resources 1973-1979

(in demand terms at 1970 factor cost prices)

Resources	1973 £m.	1% growth case				2% growth case				2½% growth case			
		1% C growth Case A		2% C growth Case B		1% C growth Case C		2% C growth Case D		1% C growth Case E		2% C growth Case F	
		£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
GDP	46,900	469	1.0	469	1.0	938	2.0	938	2.0	1,250	2.5	1,250	2.5
Net resources into (+) or out of (-) trade	-900	200		200		300		300		360		360	
Available for domestic use	47,800	269	0.6	269	0.6	638	1.3	638	1.3	890	1.8	890	1.8
Use													
Private investment	5,300	300	5.6	300	5.6	300	5.6	300	5.6	300	5.6	300	5.6
Nat. ind. "	1,300	50	3.6	50	3.6	50	3.6	50	3.6	50	3.6	50	3.6
Public Expenditure													
a Pub consumption	9,500	-403	-4.2	-755	-7.9	-34	-0.3	-386	-4.0	275	2.8	-134	-1.4
b Pub investment	2,200	-30	-1.5	-30	-1.5	-30	-1.5	-30	-1.5	-30	-1.5	-30	-1.5
c Direct exp (a+b)	11,700	-433	-3.7	-785	-6.7	-64	-0.5	-416	-3.5	245	2.0	-164	-1.4
d Indirect exp.	5,700	57	1.0	114	2.0	57	1.0	114	2.0	57	1.0	114	2.0
e Total pub. exp.	17,400	27	0.1	-641	-3.6	-7	-0.04	-302	-1.7	302	1.7	-50	-3.5
Personal Consumption													
a Privately financed (IFC)	23,800	238	1.0	476	2.0	238	1.0	476	2.0	238	1.0	476	2.0
b Publicly financed (GFC) (=B3d)	5,700	57	1.0	114	2.0	57	1.0	114	2.0	57	1.0	114	2.0
c Total personal consumption (a+b)	29,500	295	1.0	590	2.0	295	1.0	590	2.0	295	1.0	590	2.0

* Percentages are all approximate because of roundings etc.

Source: CMD 5879, our amendments)

Table 4.

Desired public expenditure growth

	1973	1974	1975	1976	1977	1978	1979
1. Actual estimated expenditure in demand terms at 1970 prices:	17,400	19,575	19,575				
2. Line 1 converted to 1975 prices:			39,150				
3. White Paper projections at 1975 prices:		35,774	36,776	37,804	38,864	39,952	41,070
4. Case A 0.1% growth (1970 demand prices) (1975 prices)	17,400	17,420	17,440 34,080	17,460 34,920	17,470 34,940	17,490 34,980	17,570 35,020
5. Case B -3.6% growth (1970 demand prices) (1975 prices)	17,400	16,700	16,110 32,220	15,550 31,100	15,010 30,020	14,490 28,980	13,980 27,970
6. Case C -0.04% growth (1970 demand prices) (1975 prices)		17,390	17,390 34,780	17,380 34,760	17,370 34,740	17,370 34,740	17,360 34,720
7. Case D -1.7% growth (1970 demand prices) (1975 prices)		17,140	16,880 33,760	16,630 33,260	16,380 32,760	16,130 32,260	15,900 31,800
8. Case E 1.7% growth (1970 demand prices) (1975 prices)		17,690	17,990 35,980	18,290 36,580	18,600 37,200	18,910 37,820	19,210 38,460
9. Case F -3.5% growth (1970 demand prices) (1975 prices)		16,790	16,200 32,400	15,650 31,120	15,090 30,180	14,570 29,140	14,060 28,120

MANPOWER CONTROLS IN THE PUBLIC SECTOR

THE NATURE OF THE PROBLEM

Almost every company in the United Kingdom today has some form of manpower budgeting and most are operating on a nil increase policy or natural wastage to actually reduce numbers. The underlying reasons for this are first, that manpower costs, with constant numbers, are currently increasing at 5% per annum in real terms as wage rates rise faster than prices in general. Second, in all manpower intensive activities, employment not only costs money itself but generates further costs both through the overheads of the individuals concerned and their tendency to generate self-justifying expenditures. Manpower controls are therefore essential to the control of real expenditure.

Of nowhere is this more true than in the public sector which is 60% labour intensive and exists primarily as an organisation to spend money in providing more extensive and higher quality services. Simply cutting "bought in" public sector expenditure without cutting public sector numbers will, therefore, do nothing to alleviate the inexorable pressure for greater expenditure which this massive labour force of 4.3 to 5.3 million is bound to generate nor the immense cost of employing one in five of the labour force at an ever increasing cost in real terms.

BASIC STATISTICS

The basic statistics are as follows:

	<u>Numbers Employed</u>		
	<u>1971</u>	<u>1973</u>	<u>1981</u>
Health	980	1040	1340
Education	1370	1510	1910
Public Administration	<u>1720</u>	<u>1790*</u>	<u>2010</u>
	<u>4020</u>	<u>4340</u>	<u>5260</u>

* Central Government 583 and Local Government 960

There are, in addition, around 1 million in the public utilities and nationalised industries. Civil Service labour costs are £3.6 billion and average £5,000 per capita. The total labour cost including local authorities but excluding public utilities is around £20 billion (say, 20% of G.D.P.).

Re-allocation within Natural Wastage

Subject to minimal exceptions, the policy would be to impose on central and local government a policy of nil replacement in total* for natural wastage (some 10% per annum) and the requirement that any deficiency in numbers in vital services should be met by manpower economics elsewhere, re-allocation of individuals between tasks or, if necessary, acceptance of a deterioration in the level of services offered. The only general exceptions to this would be services directly meeting health or safety needs (about 1 million).

Central Government: In the case of central government services the policy can be imposed by fiat and, if necessary, could allow the following refinement. Spending Ministers within one year of the commencement of this policy would be allowed to put forward requests for replacement of a maximum of one third of natural wastage but only on the basis that this is accompanied by a specific list of low priority activities (LPA list) which would have to be dispensed with as an alternative to accepting this increase. Subject to the usual auditing, the Cabinet would then choose between the relaxation of the manpower standards or the LPA. (This policy could have some substantial side benefits since any open review of low yielding activities applied to the revenue would undoubtedly show that most high tax rates are not worth collecting and this information would help make the case for their abolition.)

Local Authorities: Subject to being careful to exclude local public utilities where confrontation with the unions could defeat the government, the same principles of redeployment down to natural wastage could be applied in local government.

This would need to be enforced, however, by direct financial penalties of which the most effective would be cutting the rate support grant by four times the estimated cost of the local authority's failure to comply. To make this policy as with cash ceilings effective it would, however, be necessary to throw a financial cordon sanitaire around all the local authorities to prevent any financial difficulties in which they found themselves from jeopardising the financial system as banks and other lenders are adversely affected by doubtful local authority solvency. Such a cordon could readily be erected, however, simply by the government effectively guaranteeing existing local authority borrowing but refusing to guarantee anything other than approved increases.

* Numbers would be on a weighted salary basis to prevent substitution of higher for lower paid officials.

This would effectively cut off the supply of loan capital to any transgressing authority while, at the same time, exposing the latter to very considerable pressure from its ordinary trade creditors. In sum, it would be possible to mobilise other cash pressure by this policy.

In parallel with this local authorities would be invited to compile their LPA list and it might be worthwhile having these reviewed before a public committee in the House to get the maximum publicity and support for cuts in less beneficial expenditures.

Education and Health: These would be subject to special provisions beyond the scope of this note.

Manpower Targets: Roll Back to 1971

While strictly enforced re-allocation within natural wastage provides the method, some guiding principle as to the areas in which numbers should be cut and the size of the run down needs to be determined for general planning and control purposes. All industrial experience shows that detailed function by function examination tends to be highly ineffective since it needs a massive central staff to undertake the required examination while the very controversial nature of the conclusions in the case of government expenditure would in any case preclude the central staff from taking the ultimate decisions so that the whole issue would be referred back to the Cabinet. The latter would be overwhelmed by the scale and complexity of the problem and in the end could do very little.

A practice in companies faced with this problem is simply to adopt a policy of "roll back" which amounts to the policy decision first that numbers employed in each function will be rolled back to the level of some acceptable base year and, second, that where this target can be achieved in no other way the standing instruction is that the extent and quality of service is also to be rolled back to the base year level. (The only exceptions would be "numbers related" activities, e.g. teachers per 100 pupils.)

The base year to be chosen should be one that the policy makers (the Shadow Cabinet) are familiar with and therefore able to judge whether or not standards at that time were acceptable so that they can take the preceding policy decisions on the basis of well informed judgment. This suggests making the base year 1971. Simply rolling back even from 1973 to 1971 would potentially eliminate 330,000 jobs in public sector administration (30,000 in central and local government, 60,000 in the health services and 240,000 in education although the latter contains some "numbers related" employment). As the roll back would

ffectively be from, say, 1976/7 the potential manpower economies might well be higher by another 100,000 to 150,000.

The roll back policy could be refined on by choosing different years for different functions (e.g. making the roll back target date for local government 1959 as it is since this date that the numbers in administration alone have increased by over 250,000). Similarly, it might be overall most economic in terms of political resources and effectiveness initially to exclude highly sensitive areas such as health from this policy.

With only an effective 5% per annum natural wastage in public administration and teaching alone the reduction in numbers would be 140,000 per annum. A target of, say, 500,000 over four years ultimately saving £2.5 billion per annum (in 1975/6 prices) would therefore seem reasonable. Moreover, since 140,000 public sector jobs per annum is only .06% of the total "jobs" in the economy it should be well within the capacity of even a slowly expanding economy to create alternative employment.

CONCLUSIONS

Without acceptance of the principle of target cuts in public sector employment it would be quite unrealistic to expect that cash ceilings or any other controls of public expenditure will not be eroded over a two to three year period. Spending pressures from the 4 to 5 million still employed in the public sector, the pressure from private industries suffering prolonged depression from cut backs in "bought in" government expenditure will inevitably bring about an effective reversal of a policy which has in no way changed the basic cost generating mechanism of the public sector.

It is concluded, therefore, that we should set out the options on public sector spending and ask the Shadow Cabinet for provisional guidance on this critical issue and pointing out that if they do not accept substantial manpower reductions our committee must devote its main energies to a realistic assessment of the cost of an ultimately increasing public sector and devising means by which it can be paid for without generating immense inflationary pressures.

Given their acceptance of the principle, however, we can then provide useful guidance to other committees and develop the detailed mechanics.

A. J. Merritt

4th July, 1975