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CABINET

GOVERNMENT METHODS OF FINANCING
AND EFFECTS ON TAXATIONMemorandum by the Chancellor of the Exchequer

I fully share the concern of the Chancellor of the Duchy of Lancaster at the level of taxation in this country and I welcome suggestions as to how we can get out of our difficulties.

2. The underlying thesis in C. (54) 22 from paragraph 13 onwards is that a good deal of our trouble comes from ignoring in national finance sound commercial practice and in particular from making no proper distinction between revenue and capital accounts.

3. I fear that the analogy suggested between national finance and commercial accountancy is largely misleading. Industrial enterprises run their finances as they do because they want to know how much commercial profit they are making. But with few exceptions Government services do not involve this conception of profit at all. Indeed the fact that they do not involve commercial profit is one of the main reasons why they are run by Government Departments. There are undoubtedly "dividends" in the metaphorical sense from such things as the National Health Service and National Defence but they do not give commercial profits and it would be hopeless to try to determine how much we should spend on these services by commercial profit and loss accounts. Quite different considerations come into play.

4. There are indeed a small number of items of expenditure in the national accounts to which commercial considerations could be applied. But they are in total so small as not to affect the position significantly. The items the Chancellor of the Duchy has in mind, as evidenced by the examples he cites, are large items, the benefit of which accrues over a period of years but as a dividend only in the metaphorical sense and his proposal is to spread the cost to the taxpayer over something like the period over which the benefit accrues.

5. As a first point, it should be realised that if this treatment were introduced as regards expenditure and analogous treatment applied, as on sound principles it would have to be, to revenue, the result would be to make the situation on the current Budget worse, not better. We could not borrow for the cost of building up a strategic reserve of materials and at the same time credit to current revenue, as we shall be doing next year, over £100 millions, from the sale of food stocks on the termination of controls. On the new approach, we could not continue to credit the proceeds of death duties (£160 millions a year) to current revenue. There are other smaller items where we should have to change current practice. The net result, as I have said, is to make things worse, not better, on the current Budget.

6. The real issue raised by the Chancellor of the Duchy's paper must, however, be considered on broader lines than merely the place of particular items in our accounts. The level of the Government's total financial needs depends on the extent to which the Government requires goods and services for the activities of Departments plus the extent to which it requires to abstract money from some citizens to pay allowances, grants, pensions and so on to others. The money for this expenditure has to be provided by the citizens either as taxpayers or as lenders of their savings to the Government. How the necessary finance is distributed between taxes and borrowings depends primarily on how far the Government considers it prudent to rely on being able to borrow on reasonable terms, in suitable form and without causing inflation, having regard to the probable level of savings and the total demands for capital. This question is one of the size of the overall surplus or deficit on the Budget. It is not dependent on the place which particular items take in the national accounts.

7. The Chancellor of the Duchy's suggestions, therefore, really come to this, viz., if we can identify items totalling let us say, £300 millions in our expenditure which are of the character he describes, then we could justify a budget deficit £300 millions greater than we should have under present practice, i.e. we could reduce taxation by £300 millions below what it would be under present practice.

8. This means that we should need to borrow £300 millions more. Where should we find the necessary savings? We could not expect to get much of the extra incomes resulting from the reduction of taxation back in savings. Indeed these extra incomes would add to our difficulty by increasing the demand for consumption goods. We could not hope to generate adequate increases of national production to produce new savings of the amount required. We could, in fact, only draw into the Government's resources savings which would have gone elsewhere, i.e. we should attract savings away from private industry or suffer a worsening in our balance of payments. Failing any of these sources for the extra borrowing, the only recourse would be increase of the floating debt, i.e. inflation.

9. My conclusion on the Chancellor of the Duchy's paper, therefore, is that it is my task to continue as at present and to produce on my Budget as a whole such surplus or deficit as I think, taking all our circumstances into account, the economy requires.

10. The real fact is that this country is, and has for many past years been, carrying too heavy a load of Government expenditure. I have impressed this on my colleagues on many occasions, the latest being in C. (53) 355 as recently as 16th December last, and I have urged the vital necessity of cutting down Government expenditure. This must be our aim but it is one towards which progress has been shown to be slow. Unless we are to slash the social services - and I do not think my colleagues want to - then, except insofar as we can reduce the cost of defence and find less expensive means of giving a fair deal to agriculture, the reduction in the burden of Government expenditure can only come about slowly.

11. What we have got to do is to seek very possible means of cutting down costs, resisting additional services, simplifying services which exist and, in a variety of ways, ensuring that the actual cost of Government expenditure is not allowed to rise. Then, provided we can keep the economy on an even keel and promote a steady increase in productivity,

the real burden of Government expenditure will be reduced as productivity and the national income increases. This is a long, slow grind. We have made a start but we have got to go on with it for years and years. This is not a pleasant prospect, but it is the only course open to us.

R.A.B.

Treasury Chambers, S. W. 1.

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