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PUBLIC EXPENDITURE: PLANNING AND CONTROL

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PUBLIC EXPENDITURE: PLANNING AND CONTROL

I—Introduction

One of the Government's first tasks when they came into office was to examine the prospects and priorities of public expenditure. There were large expansion programmes in progress for the various public services, which had been published in outline in December 1963*. These did not, in the Government's view, provide adequately for the nation's social or economic needs. Even so, they would have fully absorbed for the years ahead the future growth of revenue at the rates of taxation then ruling, even if the nation had managed to achieve a regular rate of growth of the gross national product as high as 4 per cent a year.

2. The Government began a review of public expenditure in order to redeploy for more productive purposes and for the strengthening of the balance of payments the resources which were engaged on work which the Government considered to be of low economic priority; to give effect to the Government's own concepts of social priority; and to bring the growth of public expenditure into a sounder relationship with the development of the national economy.

3. The process of reshaping involved:—

- (a) A decision to limit the total growth of public sector expenditure to an average of $4\frac{1}{4}$ per cent a year at constant prices from 1964–65 to 1969–70: this was subsequently confirmed as part of the National Plan.† *not derived from Nat. Plan*
- (b) Within this total, a long-term allocation of resources to each of the main public services to provide the quantitative framework for their development.
- (c) A strict review of individual programmes, in particular of defence.
- (d) The preparation of Estimates within specified limits so as to ensure their consistency with (a) and (b).
- (e) A review of the investment of the nationalised industries to fit in with the National Plan.
- (f) More effective implementation of the programmes and an improvement of financial control, to get better value for money.

4. This White Paper describes the first results of this reshaping, the procedure which the Government adopted to carry it out, and the methods by which the Government intend to continue the process in the future to enable the public services to make the best possible contribution to the development of the national economy and to provide for the most important social priorities, the programmes of social improvement and economic expansion going forward together, each dependent upon the other, as part of the National Plan. The relevant statements of Government policy appear in Appendix I.

* "Public Expenditure in 1963–64 and 1967–68". Cmnd. 2235 (December 1963).

† "The National Plan", chapter 18, para. 3. Cmnd. 2764 (September 1965).

II—Aggregate of Public Sector Expenditure

5. The Government's object throughout has been to look at public expenditure as a whole ; to make the best possible estimate of the cost when each question has come forward for decision ; and to present the choices between different programmes and between alternative courses within them. In their first days in office the Government considered the choices open to them in this way and decided their first social priorities, which were to increase the rates of national insurance and associated benefits and to remove the prescription charges.

6. These choices are made from a comprehensive aggregate of public sector expenditure, including both current and capital expenditure by central and by local government, and the gross outgoings of the National Insurance Funds, but excluding debt interest. This total was about £10,500 million in 1964-65. It involves expenditure of many kinds, e.g., purchase of defence equipment and laboratory supplies ; the employment of soldiers and hospital staffs by the central government, and of teachers and firemen by local government ; the construction of houses, schools and roads ; payments of national insurance benefits and of national assistance to those in need ; support for agriculture ; loans and grants to firms moving to development districts ; aid to under-developed countries.

7. These expenditures are linked by three common strands. First, all are decided by Government, central and local, on grounds of public interest. Secondly, they generally involve directly or indirectly a claim on the nation's productive resources—a direct claim where the Government are employing manpower, buying goods or paying for construction, and an indirect claim where the Government pay pensions or family allowances, or give grants to universities or loans to industrial enterprises. Such "transfer payments" give their recipients a claim on resources, which becomes an addition to demand except to the extent that the payments are saved ; and in most cases the circumstances are such that the payments are spent. Thirdly, all these expenditures are paid for either from taxation, local rates or national insurance contributions, or by borrowing from the public*.

8. The investment of nationalised industries and of certain other public corporations, like the B.B.C., and the Exchequer advances to them, are handled separately. This is because the nationalised industries are enterprises producing goods and services for sale ; and the size and composition of their investment are considered in relation to the industrial needs of the economy and the commercial policy of the undertakings themselves, and have less in common with the generality of central and local government expenditure than with that of the rest of industry. Subsidies to nationalised industries, like those to the private sector, are included in the aggregate of public sector expenditure.

9. For review and control purposes the aggregate of public sector expenditure is divided into functional blocks. Each heading—defence budget, education, health and welfare, benefits and assistance, and so on—includes all the expenditure for the particular purpose. For example, the education total includes the pay of teachers and other running costs, new building, and the provision of equipment and student awards for the whole

* The receipts and expenditure of the public sector are analysed in Appendix III.

range of publicly-financed educational institutions from primary schools to universities. They are included whether they are the responsibility of the Department of Education and Science and the Scottish Education Department, or of the local authorities, or of private bodies, such as universities, receiving grants and loans from Government Departments and local authorities.

10. This classification enables the Government to consider the development of the various services as a whole, and to decide the priorities between them. Each main block is within the scope of one Minister (except where there are separate Departments for Scotland and Wales); and it is then for each Minister to consider how the resources in his block could best be used. The extent to which the whole block of expenditure is under the detailed control of the Minister will vary from case to case; but even where the Minister has no formal control, as with much local authority expenditure, the Government Department's policy and the procedures for determining the level of Government grant or approving loan sanctions for capital expenditure bring the dimensions and direction of the development of the services within the influence of the Minister.

11. The aggregate of public sector expenditure is dominated by a few large programmes. The defence budget, roads, public housing investment and subsidies, education, health and welfare, benefits and assistance account for about three-quarters of the total. Some important programmes, such as agricultural support and assistance to industry, cannot be realistically predicted over a long period; so the main programmes represent an even greater proportion of those expenditures for which long-term programmes can be drawn up in advance.

12. The period 1964-65 to 1969-70 was chosen for the review. The out-turn for the base year 1964-65 was not then known and an estimate was used: the expenditure for the year 1965-66 was to a considerable extent determined by the plans of the previous Government: four more years were then covered to 1969-70. In general, this is the most convenient period for considering the development of most of the main public services—for many it is the time required to train skilled staffs and to plan and build new capital facilities.

13. The nature and structure of most of the main public services require a planning period of four or five years. The phasing of development of these services is therefore such that substantial changes of direction cannot quickly be made without risk of dislocation. Nevertheless the Defence Review is aimed at eliminating a prospective 20 per cent increase in expenditure from 1964-65 to 1969-70; and this has involved a radical review of world-wide commitments, weapon systems and procurement arrangements. The savings thus secured will make a substantial contribution to higher rates of growth in other services of high economic or social value.

III—The 1965 Survey and Allocation

14. In order to draw up a comprehensive set of public sector expenditure programmes, the Government had to decide at an early stage how much public expenditure should be provided for in the period up to 1969-70. The preparation of forward estimates of the cost implications of public expenditure policies was a familiar one: there had been an annual Survey

of public sector expenditure from 1961 onwards, in accordance with the recommendations of the Plowden Committee*. The essential and novel element was the procedure of deciding first how much the country could afford; then deciding how this could best be deployed; and finally requiring each spending Minister to arrange his expenditure within his agreed allocation.

15. The Department of Economic Affairs and the Treasury therefore prepared an initial assessment of the growth of gross national product which could reasonably be expected, and then of the resources which were required to improve the balance of payments, to strengthen private and nationalised industries' investment, to provide for the expansion of public expenditure on the lines of the policies then ruling, and to allow for the growth of private consumption.

16. The outcome was the Cabinet's decision in January 1965 that the rate of growth of the aggregate of public sector expenditure (as defined above) from 1964-65† to 1969-70 should not exceed 23 per cent (i.e. an average of $4\frac{1}{4}$ per cent a year) at constant prices. It was necessary to decide this provisional guide-line first in order to establish an effective starting-point for the reshaping of programmes. The decision was announced in Parliament by the Chancellor of the Exchequer on 22nd February, 1965, when presenting the Vote on Account (see Appendix I).

17. The 1965 Survey of public sector expenditure began as soon as the Cabinet decision had been made, starting with instructions for a detailed costing by all spending Departments of their policies for the period 1964-65 to 1969-70. These were divided between "basic" programmes, which were to be drawn up within limits laid down in advance and related to the development of the individual services already in train, and "additional" programmes, representing the cost of further improvements which could be undertaken if more resources were made available. The programmes were prepared at constant prices, so that the change in expenditure shown from year to year excluded any effect which price changes (including changes in rates of pay) might have on the amount of money to be spent.‡

18. The returns by Departments covered the whole field of public sector expenditure. They were subjected to a rigorous scrutiny in order to ensure:—

- (a) that the financial implications of existing policies had been fully taken into account in the "basic" programmes;
- (b) that realistic costings had been made of the "additional" programmes and policies.

19. There was available to the Government in June, following this examination, a detailed Survey of the prospects for public expenditure, which covered both "basic" and "additional" programmes, and this was agreed

* "The Control of Public Expenditure". Cmnd. 1432 (July 1961).

† The out-turn for 1964-65 was lower than had been expected in January, 1965: the Cabinet's decision related to the comparison with the figures and definitions at the time of the original statement, which are set out in the tables in Appendix II.

‡ The figures for current expenditure on goods and services were prepared as nearly as possible on the same price basis as the 1965-66 Budget Estimates. Figures for capital expenditure were mostly at March 1965 prices. Payments such as subsidies and grants and loans to industry, which do not involve the direct purchase of goods and services, were measured in such a way as to make no allowance for any effects from price changes. The costings prepared on the basis described are referred to collectively as "at 1965 Survey prices"

by the spending Departments and the Treasury and the Department of Economic Affairs to be as realistic and accurate a costing as was possible.

20. The Survey provided for a contingency allowance of £100 million for 1969–70 in order to make some provision for possible needs for extra expenditure by the Government in circumstances which cannot be foreseen (e.g., for natural calamities) and for the tendency for the implementation of policies to cost more than expected. The allowance made is three-quarters of one per cent of total expenditure.

21. While the Survey of public expenditure was taking place, the preparation of the National Plan was proceeding. This work confirmed the initial decision limiting the growth of public sector expenditure to 4½ per cent a year at constant prices. The examination of the prospects of the construction and engineering industries, and the prospective supply and demand for manpower, showed where special pressures were likely to exist; and these were taken into account in the scrutiny of the expenditure programmes. One fact of particular importance was the requirement of the health and education services together with public administration for some 500,000* extra people between 1964 and 1970, a requirement greater than the total increase of manpower expected to be available. This conclusion put great weight on the importance of efficiency in the use of manpower throughout the public sector, and illustrated the existence of physical as well as financial limitations to the expansion of these services.

22. The Survey was considered, together with the relevant evidence accumulating from the work on the Plan, by a group of senior Ministers, none of whom had large Departmental responsibilities for any particular block of expenditure, under the chairmanship of the Chancellor of the Exchequer. The Ministers responsible for the main expenditure programmes were consulted one by one. In the light of this examination, the group recommended the adoption of specified limits for each of the main programmes of expenditure, both for 1966–67 and for 1969–70. The group made their report to the Cabinet in July, and decisions were taken on each of the main programmes for the two years in question. The decisions in respect of 1969–70 were announced in the National Plan.†

IV—Composition of Public Sector Expenditure

23. In parallel with this process of Survey and allocation, the review, announced in October 1964, of certain programmes was in progress; and the ultimate shaping of the programmes resulted from the combined effect of these operations and also from the day-to-day decisions taken in the course of the year.

24. The *defence review* was under way by Christmas 1964. The Defence White Paper‡ presented in February 1965, formulated the problem of finding the means by which defence expenditure during the next few years might be contained at roughly the then current figure in real terms. The continuation of previously existing policy would have involved an increase at constant prices from an estimated £2,000 million in 1964–65 to £2,400 million by

* The National Plan, chapter 2, para. 18; and chapter 3, para. 2.

† The Tables in Appendix II are developed from and supplement those in chapter 18 of the National Plan.

‡ “Statement on the Defence Estimates, 1965”. Cmnd. 2592 (February 1965).

1969-70; and after the first stages of the review the Government were able to adopt the reduction to £2,000 million in 1969-70 as a definite objective on which economic planning could be based. A series of decisions was taken from January 1965 onwards, notably on aircraft procurement, the future of the Army reserves, and the cancellation of the fifth Polaris submarine, which went more than half-way towards the target of a saving of £400 million.* Further decisions were announced in the Statement on the Defence Estimates, 1966 (Cmnd. 2901 and Cmnd. 2902, February 1966).

25. *Civil defence* preparations have also been radically reviewed and will be limited so that annual expenditure is brought below the rising level of recent years. Compared with £24.6 million in 1965-66, estimated total public expenditure in 1966-67 will be about £21.6 million. (These figures include rate-borne expenditure by local authorities.)†

26. Expenditure on *overseas aid*, which is to a large extent determined some two years in advance by previous decisions, is expected to rise from about £190 million‡ in 1964-65 to about £225 million in 1966-67 on the basis of existing commitments. The future programme will depend on periodic reviews in the light of progress made in overcoming our economic problems.

27. In the social and community services, the main characteristics of the reshaping of programmes** have been:—

- (a) A very large expansion in *public sector housing investment* and a substantial increase in *subsidies*, involving increases of 33 per cent and 68 per cent respectively from 1964-65 to 1969-70.††
- (b) A continuing expansion from 1964-65 to 1969-70 in *education* (32 per cent) and *health and welfare* (23½ per cent).
- (c) In *benefits and assistance*, an increase of 38 per cent, of which 8 per cent is attributable to growth in the number of beneficiaries; there was a large increase in the rates of benefit and assistance in March 1965; thereafter the first priority has been given to the introduction of earnings-related benefit in the early months of unemployment, sickness, industrial injury and widowhood.
- (d) The *police and prisons* services show together an increase of 22 per cent.
- (e) For *roads*, the increase is just over 40 per cent, with construction and major improvements showing an increase of over 70 per cent to £364 million in 1969-70, but even this increase in expenditure will be insufficient to match the growth of congestion in the period under review.
- (f) The control of *local authority borrowing for miscellaneous purposes* has been tightened, especially in relation to civic offices, recreational projects, the early purchase of land and advances for house purchase.

* Statement by the Secretary of State for Defence, 5th August, 1965. O.R. Cols. 1882-3.

† The outcome of the Government's review was described by the Secretary of State for the Home Department in a Statement on 2nd February, 1966 (O.R. Cols. 1089-91), which gave figures of Exchequer expenditure only.

‡ This figure differs from the corresponding figure in Table 1, Appendix II because it is based on later information.

** The programmes (a), (b), (c), (e) are more fully described in chapters 12, 17, 20, 21 and 22 of the National Plan.

†† Provision for the increased subsidies is being taken in the Housing Subsidies Bill and the Housing (Financial Provisions) (Scotland) Bill.

28. On the economic side, major decisions include the schemes to introduce an entirely new system of investment incentives to concentrate Government assistance where the need to increase investment is greatest;* and to set up an Industrial Reorganisation Corporation to promote greater efficiency in British industry through schemes of rationalisation and modernisation.† In addition, a large number of measures have been taken or announced to stimulate mobility of labour and advanced technology, with considerable extra expenditure, e.g., expansion of training facilities; special funds for the National Coal Board to expedite closure of uneconomic pits; increased funds for the National Research Development Corporation's investment in innovations in such fields as computers, machine tools and process control; encouragement of farm amalgamations; export promotion; and the National Ports Council's development programme.

29. The composition of public sector expenditure (Appendix II, Table 1) will change considerably in the next few years. Defence and related expenditure will proportionately be taking much less: there will be greater expenditure on incentives and services which are designed to improve the performance of the national economy: the need to improve the social infrastructure, notably in housing but also in communications, related to regional development will certainly involve large increases particularly of capital expenditure: the education and health services will continue to expand: and the growing numbers of old people, and the desire to improve their standard of living in line with that of the rest of the community, will involve rapidly increasing expenditures on benefits and assistance of all kinds.

30. In terms of economic category also the composition of public sector expenditure will change between 1964-65 and 1969-70 (Appendix II, Table 2). Capital formation (i.e. expenditure on houses, roads, schools, hospitals, etc.) is likely to increase by nearly 50 per cent: this expenditure together with the investment of the nationalised industries‡ and other domestic capital expenditure** is set out in greater detail in Table 6 of Appendix II and shows a total increase of nearly 28 per cent. Current expenditure on goods and services is likely to increase by only 15 per cent with the stabilisation of defence expenditure, nearly all of which, whether of current or capital character, is, under national accounting conventions,†† included in this category. The 38 per cent increase in current grants to persons is due predominantly to benefits and assistance, but there are other rapidly expanding items here, such as grants to universities.

31. In Appendix II, Table 3, the totals are divided by spending authority—Government Departments, national insurance funds, local authorities. The increase in local authorities' expenditure, current and capital, is put at 35 per cent, reflecting the development of education, roads and housing. This rapid prospective growth of local authorities' expenditure is the background to the revision of the Exchequer grant in aid of local government expenditure

* "Investment Incentives". Cmnd. 2874 (January 1966).

† "Industrial Reorganisation Corporation". Cmnd. 2889 (January 1966).

‡ Appendix II, Table 5.

** For a definition of this term see footnote (1) to Table 6, Appendix II.

†† See explanatory notes to Table 2, Appendix II.

which is now under discussion between the Departments and the local authority associations, and which will be the subject of legislation during the present Session of Parliament.

V—Development of Long-Term Programmes

32. The 1965 Survey and allocation operations have established guidelines for the development of each of the main services, with specific limits for 1966–67 and 1969–70. Similar limits will be established for those smaller services for which it is practicable to draw up a long-term programme.

33. These five-year guide-lines have a dual purpose, for they provide a framework both for the planning of the service and for financial control. The Minister in charge of each service has as much assurance as it is practicable to give of the resources which will be at the disposal of the service. This enables him to plan how to use them to the best advantage, and it greatly eases the day-to-day operation of financial control.

34. The extent to which there are specific long-term programmes in physical terms depends upon the administrative and technological content of each service. In defence, the period of weapons production is so long that ten-year costings are needed, and have been used for some years. The functional costings system* has also been set up as a tool for long-term defence planning. The technology of the road programme requires that it should be planned in detail over a period of five years, with some judgment made of what development will be possible for a further period of years. In the education programme, the two crucial long-term factors are the supply of teachers and the supply of buildings; and for the latter it is the general practice for programmes of starts to be authorised to local authorities and universities three or four years ahead (i.e. in respect of buildings to be finished five or more years ahead). In the health service, a long-term hospital programme is in progress, and the allocations for running costs are settled firmly for the coming year and provisionally for the next year or two thereafter. In housing the need to plan well ahead, covering both the public and private sectors, has become increasingly evident.

35. This long-term planning of the public services has developed far in recent years and will be extended further; and this can now be done with more assurance. The shift of emphasis to the evaluation and appraisal of long-term programmes and the long-term allocation of resources to them is leading to the development of better methods to measure and compare the cost-effectiveness of alternative courses of action. In the various economic services, and particularly the investment of nationalised industries, the techniques of appraisal are being continuously improved (see paragraph 44 below). Likewise in defence, the appraisal of the military effectiveness of alternative weapon systems in relation to their cost is now being increasingly developed: the process makes it possible to choose either the cheapest means of accomplishing a defined military objective, or the means of deriving the maximum military value from a given expenditure of resources. There are analogous opportunities for applying similar techniques in the social and community services; and as the long-term programmes become more clearly defined, the use of these tools of management will extend, and better value for money will result.

* Statement on the Defence Estimates, 1965, paras. 36–40.

36. The extension of commitment of the national resources for several years ahead means that there has to be an element of flexibility in the programmes, as is shown in paragraphs 56 *et seq.* below. They represent too large a part of the use of resources to be independent of fluctuations in the national economy. Moreover, the physical programmes themselves need to be flexible enough to be adjusted for unexpected population movements, changes in costs and techniques, and new social and economic developments.

37. About 85 per cent of the whole of public sector expenditure is of a kind which is suitable for long-term planning within fixed financial limits, though the scope for specific long-term programmes defined in physical terms on the lines described is much less. For this 85 per cent it would appear to be possible to draw up five-year costings of expenditure with a sufficient degree of realism to permit an allocation to be made and financial control to be exercised accordingly.

38. For the remaining 15 per cent, for which it is impracticable to draw up a long-term programme or to work to a long-term financial allocation, other forms of control ensure that aggregate expenditure on these does not increase excessively fast and carry the total of public expenditure above the level which has been laid down.

39. In most of these cases, the cost of a specific policy in a particular year can be forecast only within wide limits. The out-turn of the agricultural subsidies every year will depend heavily upon the level of production and the course of world prices: under the present guaranteed price system, therefore, it is impossible to confine this part of expenditure on agriculture within predetermined limits. Expenditure on agricultural services and on the long-term improvement of agriculture is also difficult to forecast, but it is less subject to wholly unpredictable factors. Firms moving to the development districts have been entitled to grants for buildings and for plant and machinery at fixed percentage rates; but this has not enabled precise estimates of expenditure to be made since it has proved very difficult to predict how many applicants there will be and how long will elapse before the grants require to be paid. The size of the British Railways Board deficit depends in part on variable factors beyond the Board's control. Some kinds of work, particularly but not exclusively in the field of advanced technology, are subject to large and unforeseen escalations of cost.

40. In each of these illustrations, however, the Government's actions are of major importance to the cost. The strength of the stimuli given to production in the Farm Price Review, the size and attractiveness of grants under the Local Employment Act, decisions on proposals to close uneconomic railway services, the cost control of the projects which are liable to escalate: all lead clearly to short-term and long-term increases or decreases in cost. The importance of cost-effectiveness and of the appraisal of proper choices is as great here as in the services for which long-term programmes are practicable.

VI—Nationalised Industries

41. For reasons described in paragraph 8, the investment of nationalised industries is not included in the aggregate of public sector expenditure, and is not therefore subject to the limits imposed upon this aggregate. The invest-

ment of these industries, and their sound development, are at the centre of the National Plan, partly because of their strategic importance to the economy, and partly because of their size (capital £8,800 million ; labour force approaching 2 million ; output about one-tenth of gross domestic product ; investment of £1,300 million in 1965-66, or about the same as that of the whole of manufacturing industry). They are also of great significance because they depend upon the Exchequer for their supplies of new capital in so far as they cannot provide these from their own resources.

42. These investment programmes were examined in order to ensure that their size and content were adequate to provide the necessary energy, transport and communications for the economic expansion provided for in the Plan. The estimated capital expenditure in 1964-65/-66/-67 and in 1969-70 is set out for each undertaking in Table 5 in Appendix II. This table incorporates the decisions on these programmes taken by the Government since the publication of the National Plan.* The rapid expansion in recent years which is expected to take the total of nationalised industries' investment up from £1,200 million in 1964-65 to £1,450 million in 1966-67 is coming to an end, and the total is expected to fall to £1,400 million by 1969-70. The effect of this course will be to free resources after 1967 for other public investment, for private manufacturing investment, and for exports.

43. Of the increase from 1964-65 to 1966-67 of £274 million, or 23 per cent, in nationalised industries' investment, £122 million is attributable to electricity, £61 million to gas, and £70 million to the Post Office. Proposals for a further increase in investment by the gas industry in 1966-67 are now under consideration. In the following years to 1969-70, the level of Post Office investment will expand substantially. This should be offset by the fall in the electricity programme expected to occur once the necessary margins in generating, transmitting and distributing capacity have been built up: but the position will be reconsidered during the course of this year's investment review when fresh forecasts of the demand for electricity will be available which, amongst other things, will take into account experience this winter.

44. The scale of the investment is such that the Government and the industries themselves are devoting increasing attention to the techniques and criteria for investment appraisal. Allowance must be made for the social and non-economic obligations which most nationalised industries are required to undertake. But having done this, it is essential, in order to ensure the most efficient deployment of the national resources, that the minimum return on new capital in the nationalised industries should be comparable with that obtainable elsewhere in the economy. The most up-to-date techniques are being developed in order to carry this into effect. The appraisals of the development of the nuclear power programme, of the choice between the various projects for developing the South Wales iron ore ports†, and of the electrification of the railway line from London to Southampton and Bournemouth are important recent examples.

45. The financial objectives which are agreed from time to time between these industries and the Government define the return to be sought on the industries' capital assets as a whole and are the guide-lines for the indus-

* The National Plan, page 57.

† "Iron Ore Imports into South Wales". Cmnd. 2706 (July 1965).

tries' commercial policies. The nationalised industries, like other industries, are subject to the Government's general policy on prices and incomes. The Government have made it clear that they expect these industries to do all they can to absorb increases in costs by increasing efficiency; and have referred nationalised industries' price proposals to the National Board for Prices and Incomes.

46. Over the entire field of nationalised industry, the return on capital in 1964-65 averaged 4.2 per cent. There is a wide variation between the financial objectives of 8 per cent (net of depreciation at historic cost) and 12.4 per cent (gross) for the Post Office and the electricity supply industry respectively, and the poor financial results of the railways and the coal industry. The lower the return, the greater is the call on the Exchequer; and in spite of the improved financial performance in recent years, the industries borrowed over £550 million from the Exchequer in 1964-65, and are expected to borrow about £650 million in 1965-66.

47. Where it has been necessary to undertake full scale reorganisation of an industry to meet changed economic circumstances, substantial sums of capital have also had to be written off or placed in suspense: £1,192 million for the British Transport Commission in 1962, £110 million for the British Overseas Airways Corporation* and £415 million for the National Coal Board in 1965. These write-offs are, in accounting terms, a recognition of the changed value of the assets they represent, but the cancellation of the industries' debt to the Exchequer which enables these sums to be written off in no way reduces the burden on the community. The Exchequer lends to the industries at the same rate as it borrows in the market. The interest payments made by the industries to the Exchequer just suffice to meet the interest payments which the Exchequer must itself make to those from whom it has borrowed. When Exchequer loans to the industries are cancelled as part of a capital reconstruction, the Government must of course continue to pay interest to the original lenders. The cancellation of Exchequer loans to the amount of over £1,700 million in respect of the three reorganisations above involves an annual permanent burden to the Exchequer on this account, which is at present of the order of £70 million.

VII—Phasing and Implementation

48. The preceding sections describe the method by which the Government have undertaken the reshaping, which they began in October 1964, of public expenditure programmes. They start from the Government's decision to contain the aggregate of public sector expenditure within a definite limit up to 1969-70; describe the process of the Survey of public expenditure and long-term allocation of resources between the main public services which followed; and set out the pattern of expenditure which is likely to develop. This is the establishment of a framework; and this section sets out the problems that arise in working within this framework.

49. First, the wide variety in the purposes, functions and economic nature of public expenditure, in the authorities responsible for it, and in the time-scales of the decisions involved, present a formidable problem of forecasting future costs and containing expenditures within the limits laid down. Within

* Parliamentary authority is being sought in the Air Corporations Bill.

the 85 per cent of the aggregate of public sector expenditure for which forward costings of policy can realistically be undertaken, there is no reason to doubt that the quality of the costing will improve, though there will probably continue to be a tendency to underestimate the future cost of carrying out particular policies.

50. The question of control is more complex, because of the variety of public authorities whose expenditure is involved. The expenditure of the Government Departments is of course under the continuous control exercised through the annual Estimates, and the out-turn is normally within a reasonable margin of the original Estimates: in the last five years, the differences have been +1.7 per cent, +3.5 per cent, +1.5 per cent, -2.3 per cent, and -1.1 per cent respectively (all in money terms). But the margins increase considerably as the period lengthens. The expenditure of the National Insurance Funds follows precisely from the Government's decisions on the various benefits and the numbers eligible for them, which can usually be predicted within a narrow margin. The extent to which the central government can affect the level of local authorities' expenditure, which is about one-third of public sector expenditure, varies widely. There is control over their capital expenditure through loan sanctions and in some cases through specific statutory powers. For current expenditure, there is in general no specific Government control; but the local authorities' policies are in many cases the expression of national policies, and are subject to Departmental regulation, and the fixing of levels of grants affects the ability of the local authorities to incur expenditure.

51. Taking public sector expenditure as a whole, it is not possible to exercise a fine control over substantial periods ahead, but the essence of the long-term allocation system is to ensure that the decisions involving commitments of economic resources for the future are taken according to a rational pattern of priorities and a realistic view of the implications for the national economy of providing these resources; and the technical possibilities of costing and of financial control would seem adequate to support this.

52. A problem not yet fully resolved is that which arises from the fact that the Survey and allocation of public sector programmes, and consequently the long-term programmes of the Departments, have to be carried out in terms of constant prices because price changes do not affect the different programmes in a uniform way. This gives rise to difficulty in comparing the actual expenditures recorded after the event with the provision made in the programmes. Moreover, figures at constant prices obscure the fact that there may be pay and price increases of an exceptional character. Further, from the point of view of financing, the increases in costs caused by increases in pay and materials prices are as significant as those required by the expansion of the public services, and anomalies may arise when one kind of cost increase is treated differently from another.

53. The treatment of future expenditure in terms of constant pay and prices tends to underestimate the future weight of the public services in relation to the national economy as a whole. Wages and salaries represent a relatively larger part of the total cost of public services than of industry generally, and the concept of the "productivity" of workers in services like defence and health and education cannot be as clear as in industry.

Hence, if pay goes up in the public services at the same rate as in the private sector, the "price" (cost per unit in money terms) of providing these services will rise faster than the average price level for the economy as a whole. This tendency is obscured in the programmes based on constant prices, and emerges in practice only as events unfold.

54. Secondly, there is the need to work the system with a due flexibility. To control public expenditure too rigidly in terms of an aggregate could lead to anomalies. Some kinds of public expenditure are potentially advantageous in their effect upon the national economy: the composition of the total of public expenditure is as important as its size; and if the composition is favourable for economic growth it is possible for the nation to "afford" a larger total than if the composition were unfavourable. Some kinds of public expenditure, on the other hand, call for particularly scarce kinds of resources, and must be limited accordingly. Great restraint on Government expenditure overseas is likely to be necessary for as far ahead as can be seen. The public sector is such a large user of construction and some kinds of skilled manpower that its requirements have to be examined carefully from this point of view. The total amount of such public expenditure that the nation can "afford" will depend upon the measures taken both in increasing supply and restraining demands to deal with these particular constraints. Again, the new system of investment grants to manufacturing and extractive industries will substitute Government expenditure for tax reliefs. Changes of this type, even when they are fiscally exactly equivalent, result in more or less "public sector expenditure" as defined in paragraph 6 and thus make it necessary to re-define the total limits accordingly.

55. The Government are likely to continue to need to establish a limit to the total of public sector expenditure in order to serve as a guideline: but there may in future be room for changes in the definition and boundaries of the aggregate to which a limit is applied.

56. Thirdly, there is the phasing of the programmes. In the early stages of the five-year programme, the rate of increase in public expenditure is above the average annual rate from 1964-65 to 1969-70 of $4\frac{1}{4}$ per cent. Thus, the increase at constant prices from 1964-65 (as estimated at the time of the Survey) to 1965-66 is estimated at $5\frac{3}{4}$ per cent after taking account of the deferments announced on 27th July, 1965 (see Appendix I). This was mainly because the programmes which the Government inherited on coming to power provided for very large increases in this period. The increase at constant prices from 1965-66 to 1966-67 is not likely to exceed $4\frac{1}{4}$ per cent (see paragraph 70 below); and during the later years of the programme the growth of public expenditure is likely to be less than $4\frac{1}{4}$ per cent a year, with the flattening out of the defence programme playing an important part in this result.

57. Thus the pattern of the programmes in the five-year period is a faster increase in the early years than in the later, a similar course to that in the total of nationalised industries' investment programmes (see paragraph 42).

58. The immediate increase in public expenditure was more than the economy could bear, having regard to the pressure on resources and on the balance of payments, and the Government therefore took the special measures announced by the Chancellor of the Exchequer on 27th July, 1965. These

P. W. itself responsible for
airload.

were designed to moderate the rate of growth of public expenditure as effectively as possible, and with the least possible interference with the most urgent social programmes. They concentrated on slowing down the rate of expenditure on capital projects and on deferring purchases of equipment and stores, and they covered the whole of the public sector, including Government Departments, local authorities and nationalised industries.

59. It was necessary to act rapidly to reduce the overload, and this made it impossible to carry out a detailed adjustment of programmes. The Government therefore decided to postpone the starting dates of non-industrial projects for six months, but exempted all projects in development districts, and houses, schools and hospitals. Loan sanctions were to be given only in special circumstances for local authority loans for expenditure on land purchases in advance of requirements, on civic buildings, offices and a variety of miscellaneous projects; and lending by local authorities on mortgages for house purchase was restricted. Government Departments were instructed to act accordingly; circulars were sent to local authorities inviting their action likewise; and the chairmen of the nationalised industries were asked to help also.

60. It is estimated that central and local government capital expenditure projects to a total value of at least £200 million have been deferred for six months. The effect of these deferments will be to reduce expenditure in 1965-66 by some £40 million and in 1966-67 by about £60 million. In addition to this the deferment of expenditure by Government Departments on stores and equipment will lead to further savings of £7 million in 1965-66 and £6 million in 1966-67.

61. The Chancellor wrote to the chairmen of the nationalised industries drawing their attention to the measures being taken to restrain expenditure in the public sector and asking for their co-operation in comparable measures. He made it clear that he was not asking for postponement of projects which were essential to economic growth over the next few years. As a result the industries offered to defer expenditure of the order of £60 million. The Chancellor has recently followed up his earlier approach and the industries are now likely to make an even greater contribution.

62. These deferment measures were temporary, and were designed to reduce the pressure of demand below the excessively high level which it would otherwise have reached. They have reduced the load on the building industry, and they have contributed to the improvement in the balance of payments. It was clearly necessary, however, that this temporary deferment of projects should give place to more normal methods of control; and on 8th February, 1966, the Chancellor of the Exchequer announced that revised annual expenditure limits were being fixed accordingly, so that the savings of expenditure in 1965-66 and 1966-67 would be made, but that the Departments would be able to re-programme their investment within the limits laid down (see Appendix I).

63. In the development of the long-term programmes the question of phasing will recur, for public expenditure is too large an element in the national economy to be treated entirely on a long-term basis independently of the short-term economic situation.

VIII—The 1966–67 Estimates

64. The procedures described in section III to determine the allocation of resources to the main public expenditure programmes five years ahead also resulted in allocations for 1966–67. For the expenditures on Votes this made it possible to establish a framework, taking account of the deferment measures of 27th July, 1965, within which each Department was required to prepare its Estimate for 1966–67. Special instructions were given to those Departments whose expenditures were not suitable for long-term programming. Many of these depend heavily upon the economic and international situation at the time when the Estimates are settled. Nearly all the Votes are strongly affected by the course of wages and salaries and prices generally.

65. When the Estimates had been submitted to the Treasury in December and had gone through the initial process of examination, the outstanding questions of policy on them were referred to the same group of senior Ministers who had considered the long-term allocations in July 1965 (see paragraph 22) in order to ensure that the same standards of stringency and priority were being maintained over the whole range of Government expenditure.

66. The total of the Estimates for 1966–67 was ultimately fixed at £7,728 million, an increase of £594 million, or 8·3 per cent over the Budget Estimates for 1965–66. Of this increase, £70 million is attributable to changes in classification, i.e. to the inclusion this year in Votes of expenditures which would otherwise appear as reductions of revenue (e.g., the corporation tax relief in respect of overspill) or which were formerly advanced from the Consolidated Fund (e.g., advances to the National Research Development Corporation). Of the remaining £524 million, it is estimated that £387 million is attributable to increases in pay and prices. The increase of expenditure at constant prices is 2·8 per cent, or, after adjustment for changes in classification, 1·8 per cent. The corresponding figure this time last year for the money increase from 1964–65 to 1965–66 was 8·9 per cent, and for the increase at constant prices was 5 per cent (compared with the above 1·8 per cent).

67. The full analysis of the Estimates will appear in the Financial Secretary's Memorandum on the Estimates to be published in March. The following table shows the main changes on a comparable classification, the total increase in which is 7·3 per cent :—

	Budget Estimates 1965–66	Estimates 1966–67	Increase in 1966–67 over 1965–66	
	£million	£million	£million	Percentage change
Defence Budget	2,120	2,172	52	2·5
Transport, industry, agriculture, re- search	971	1,026	55	5·7
Health, education, housing, non- specific grants to local authorities	2,283	2,604	321	14·1
Other	1,760	1,856	96	5·5
TOTAL	7,134	7,658	524	7·3

68. In terms of constant rates of pay and prices, the Defence Budget for 1966-67 is lower than that for 1965-66, and is now within the Government's target of £2,000 million at 1964 prices. Subject to the passage of the necessary legislation, purchases of United States aircraft financed by the special credit will not be a charge on the Defence Budget until the credit has to be repaid.

69. The rest of the Estimates on a comparable classification are up by £472 million or 9·4 per cent, of which about 5 per cent represents increases of pay and prices. Of this increase, the non-specific grants to local authorities (general grant, rate deficiency grant and the new rate rebates), a large proportion of which is for education, represent £170 million; the National Health Service £116 million; universities and other Department-financed education £21 million; roads £20 million; and industrial and scientific research £18 million. The Estimates for payments from the Exchequer for benefits and assistance show a relatively small rise because the last uprating took place in March 1965.

70. The Government's objective is to contain the growth of public sector expenditure from 1964-65 to 1969-70 within an average increase of $4\frac{1}{4}$ per cent per year at constant prices. Of the aggregate of public sector expenditure as defined for this purpose, the Estimates represent over 60 per cent; and these are increased in 1966-67 by 1·8 per cent at constant prices. The remainder consists of Government expenditure not financed by Votes (including the special aircraft credit), and the expenditures of the National Insurance Funds and local authorities to the extent that these are not financed by Exchequer grants. It is too soon to make a firm estimate of the increase of these non-Vote public sector expenditures in 1966-67 compared with 1965-66, but it may be regarded as reasonably assured that the aggregate of public sector expenditure in 1966-67, as defined in the Government's objective, at constant prices, will exceed that of 1965-66 by less than $4\frac{1}{4}$ per cent.

IX—Conclusions

71. In conclusion, the Government have two approaches to the problem of expenditure planning and control, one the relatively long-term and one the short-term. The decisions establishing limits for the main programmes for 1969-70 have provided a framework for the development of these services, and enable the Ministers in charge of these services to make their priority choices and plan ahead. This covers most of the field, and should ensure that these main services will be expanded on a scale which can be accommodated within the nation's resources and taxable capacity. Once the total has been established, to spend more on one item means spending less on something else; and this is a true system of economic and social priorities. It is for debate and discussion how these choices should be modified in the years ahead.

72. The implementation of the long-term programmes, together with the process of taking decisions on those elements of public expenditure which are not suitable for long-term programming, are brought into sharper focus in the work on the Estimates, which is designed to ensure that the rates of development are kept within the limits which have been laid down, and to ensure that the short-term needs of the national economy are fully reflected in the course of public expenditure.

73. The Survey of public sector expenditure is an annual one, and the 1966 operation will decide what aggregate increase over the level established for 1969-70 will be practicable for 1970-71, and how this is to be allocated between the main programmes. This is how part of the Plan will roll forward another year, with guide-lines for the development of the main services for a further year ahead. At the other end of the time-scale, decisions will be taken on the limits for 1967-68, which will again be the basis for the work on the Estimates in the autumn of 1966. As the process becomes more firmly established, the Survey and allocation operation will increasingly take the form of a determination of long-term strategy in the outlay of public sector expenditure, brought to a point of decision in the allocation between the main programmes for the fifth year ahead, and the fixing of the limits for the short-term need for cash for the Estimates for the year immediately ahead.

74. The decisions taken by the Government within the last year have formulated financial objectives for the development of the defence, industrial and social service expenditure programmes consistent with the needs and capability of the economy as a whole. It was made clear in the National Plan* that the successful accomplishment of these programmes was contingent upon the success of the economy in developing along the lines indicated in the Plan. It will be necessary for the Government to control the phasing of the public expenditure programmes within the general limit of the average increase of $4\frac{1}{4}$ per cent a year at constant prices over the five-year period so that the load on the economy which they represent does not increase faster than the economy can bear.

75. The Estimates for 1966-67 are an important step along this path. They reflect the results of the first reshaping of the individual expenditure programmes; and this first stage of the implementation of the long-term programmes has been achieved fully consistently with the aggregate limits of public sector expenditure which the Government laid down in their early months of office.

* The National Plan, page 181.

APPENDIX I

Statements by the Chancellor of the Exchequer on Public Expenditure

Extract from the Budget Statement, 11th November, 1964

[O.R. Cols. 1029-31]

[Mr. Callaghan]

The expenditure programmes that we found in being for defence, the social services, houses, schools, hospitals, roads, will all entail substantially increased expenditure every year. By 1968 the total expenditure in the public sector will be £2,000 million more than it is today, without making any allowance for increased prices in the interim. This future expenditure is based on the revenue and savings that would accrue from a growth rate of 4 per cent in our gross national product. Hon. Members will know that the average annual increase in our national product over the last five or six years has been only about 3 per cent, or a little less, and over the whole period from 1951 onwards has been no more than $2\frac{1}{2}$ per cent.

Putting it another way, the previous Administration have pledged our future revenues for the next four years on the basis of an underlying growth rate that they did not achieve and, looking at their record, they were unlikely to achieve. Of course, it is possible that the previous Government would have achieved and maintained a 4 per cent growth rate for the next four years in a row. I do not say that miracles cannot happen, but the programmes that we have taken over have been planned on the assumption that the miracles have already happened. Many of these programmes—current and capital—are, in practical terms, already committed. It will take time to reshape them, but we intend to do this.

Our first objective is to get the deployment of economic resources right. For example, large and important parts of our industrial and technological manpower and capacity are locked up in production and research for the Government. It will be our urgent task to see how far this pattern should be modified in the national interest so as to release resources for more productive purposes and for the expansion of exports. Defence will be in the forefront of this examination. This year's figure is over £2,000 million, of which £350 million is spent overseas and is a direct burden on the balance of payments. This is the important point. The failure to secure value for money in the defence field has become a byword throughout the country: by relating commitments to resources it is our intention to ensure that the Armed Forces are able to discharge their task with greater effectiveness and economy.

We shall also examine those Government expenditures in the civil field which have an economic aspect to ensure that an adequate economic and financial return can be secured for the industrial and scientific manpower and capital which they absorb. The purpose of much of this expenditure is sound enough and it is not our intention to hack it with a meat chopper. In the first instance, therefore, we intend to ask a task group of senior officials including scientific and economic advisers to sort out these projects and appraise their economic priority. We shall then have a firm basis for action.

Next, my hon. Friend the Chief Secretary will be reviewing the remaining field of civil expenditure and I have asked him to consider whether the priorities at present established are right or whether it is possible for the Government to release valuable men and plant for work which will strengthen the balance of payments and help expanding industry. We are looking for all economies, not just tiny economies, although it must be part of the Chief Secretary's task to try to get rid of the kind of waste to which the Comptroller and Auditor General has drawn attention in recent years. But our basic objective is to find substantial cases where expenditure is not yielding full value in social and economic terms.

To turn to the other side of the medal, there are, clearly, fields in which increased expenditure by the Government can help the modernisation of the economy and the improvement of the rate of technical progress. The help that is being given to ensure more rapid development in the under-employed areas of the country is a good example of this. I very much welcome the discussions which my right hon. Friends the First Secretary and the Minister of Labour are about to have with industry to help men move easily from jobs where productivity is relatively low and opportunities are few to more productive and progressive employment.

*Extract from a Statement by the Chancellor of the Exchequer on 22nd
February, 1965*

[O.R. Cols. 35-37]

[Mr. Callaghan]

The Vote on Account, covering the Civil Estimates and the Defence (Central) Estimate, is being published this afternoon . . . It is the Government's task to plan the purposive use of our economic resources as a whole, in order to secure, first, that total expenditure both public and private matches the resources that can be made available, and, second, that within the total there is a proper balance between the requirements of the public and private sectors. This means that the public sector may need to absorb a larger share of our gross national product than it does today. But the growth of public expenditure must be effectively controlled so that social and economic priorities can be duly secured in the National Economic Development Plan which the Government are preparing.

We have accordingly been considering the problem of planning the longer-term course not only of Central Government expenditure, but of the total expenditure of the whole public sector. A final decision on the details of this will be reached when the plan has been drawn up. Meanwhile, the Government have decided that the growth of public sector expenditure between 1964-65 and 1969-70, excluding the investment of the nationalised industries, will be related to the prospective increase in national production, which in our present judgment means limiting the average increase in public sector expenditure, taking one year with another, to $4\frac{1}{4}$ per cent a year at constant prices. This will mean a corresponding containment of the rise in private sector expenditure. Only as a nation succeeds in raising the annual rate of production can public and private expenditure be increased.

These decisions will provide a sound base for our policies for modernising and expanding the national resources. They will also permit the progressive development of our economic and social policies, because expenditure will be realistically related to our capacity to embark upon new plans.

[Mr. Callaghan]

I now come to public expenditure. Both in my statement of 22nd February and in my opening remarks today I have made it clear that it is our intention to plan the use of economic resources and to control the growth of public expenditure so that the right balance of economic and social priorities can be duly secured. The control of public expenditure will therefore be used positively as well as negatively. The Government have decided that the growth of public expenditure between 1964-65 and 1969-70 will be related to the prospective increase in national production. In the Government's present judgment this means limiting the overall increase in public sector expenditure, excluding the investment of the nationalised industries, and taking one year with another, to $4\frac{1}{4}$ per cent a year at constant prices. We are examining the whole of public expenditure again in order to determine a proper order of priorities and to control waste.

In the field of defence, reviews are being conducted to ascertain the changes that would be required to contain expenditure at roughly the 1964-65 figure in real terms. One of the most serious aspects of this problem is the growth of overseas military expenditure. This includes maintaining our troops in Germany, the Middle East and the Far East. Since 1959—I ask the Committee to note these figures—this total has gone up year by year without let or hindrance from about £175 million to over £300 million, including defence aid. These payments across the exchanges constitute a serious drain on our balance of payments. A reduction in them depends upon others as well as ourselves, but the economy badly needs some of the foreign exchange resources absorbed by the defence programme; and the Government intend to secure a reduction in the existing burden.

Altogether, about $1\frac{1}{2}$ million men and women are employed in the Forces and in industry to supply them. These are important and scarce resources of manpower, needed for industrial expansion and for exports. It is against this background that the Government have had to consider the future of the TSR2 project. My right hon. Friend the Secretary of State for Defence hopes to catch your eye later in the debate this evening, Dr. King, in order to make a full statement about the Government's policy and its decision to cancel the project.

The effect of this decision is to save £35 million of Government expenditure in 1965-66, after taking account of the terminal costs which may become due to be paid this year. But, so far, this aircraft has cost £125 million, and the cost is mounting fast every week. It has, and would have, diverted hundreds of factories employing thousands of skilled and semi-skilled men from other work of national importance, including exports in particular. This is not a sensible use of our overstrained resources. The Government's decision will, in the next five years, release £350 million of resources of an advanced kind for more productive work.

On expenditure in industry, my colleagues' statements in the last few days about postal charges, railway closures and agricultural support demonstrate our policy—and we do not intend to be moved from it—that

these industries should continue to increase their contribution to the national economy. Where we believe that Government expenditure can have a constructive and fertilising effect on industry, we have shown ourselves ready to make the money available. In education, in health, in social security and in housing we are engaged in arranging our priorities so that we can get the best combination of programmes and the best value for money within the expenditure which can be devoted to these purposes.

Side by side with this is the review of local government finance which is going on, which will enable us to decide how the expenditure on the public services can best be shared between central and local sources of finance. It is no easy matter to reshape public expenditure in a short time and we must look further ahead than just the current year if we are to make a real impact on these expenditures. But I commend to the Committee, and especially to my hon. Friends, the words of Robert Owen:

“Beneficial changes can alone take place by well digested and well arranged plans temperately introduced and perseveringly pursued.”

I know only too well, as my predecessors did, of the pressure for higher pensions and for better pay; and I do not need to recall to any hon. Member the recent outcry about the state of some of our schools, the condition of some of our hospitals and the wretchedness of some of London's housing. My earnest wish is to see the nation freely and willingly devoting the necessary resources to satisfying the simple needs of ordinary men and women—a home to live in, a school to learn in, a hospital when we are sick and a modest living for the elderly. But the fulfilment of these plans jostles against the need for a healthy balance of payments as well as the desire by all of us as individuals for an increase in our own personal standards of living.

For the reasons which I gave at the outset, in 1965 first priority must be given to balancing our overseas payments. I have already indicated the manner in which we are setting about this. Until we get this, we shall need to contain the rise in private expenditure. For the rest, a healthy balance of payments is necessary to enable the economy to grow at a steady pace. Our most important task is to reconcile faster growth with a satisfactory balance of payments. We look to the economic plan which is now being prepared to co-ordinate the conflicting claims made upon our resources by private expenditure, social expenditure, defence and industrial investment; and also to stimulate the economy into greater efficiency and productivity.

*Extract from a Statement by the Chancellor of the Exchequer
on 27th July, 1965*

[O.R. Cols. 228–30]

[Mr. Callaghan]

... This year's balance of payments deficit is likely to be well below half last year's figure. To ensure that we reach our aim of eliminating the deficit in the course of next year and of maintaining the strength of sterling, the Government have decided to adopt the following measures.

First, expenditure at home. The Government intend to slow down the rate of expenditure on capital projects and to defer as far as possible

purchases of equipment and stores by Government Departments, local authorities and nationalised industries.

Housing, schools and hospitals will be contained within their existing programmes. For other non-industrial capital projects for which contracts have not yet been signed, the starting dates will be postponed for six months. Exemptions will be made for projects in development districts and areas of high unemployment. (Similarly, purchases of goods will be deferred to the maximum possible extent.)

All Government Departments have been instructed to carry out this policy and to arrange for other bodies for which they are responsible to do likewise. The nationalised industries will be called on to follow a similar course of action. Local authorities will be asked to follow suit.

Loan sanction and grants will only be given to local authority projects which are urgently required. In particular, sanction will not be given except in special circumstances to loans for expenditure on land purchases in advance of requirements, on civic buildings, offices and a variety of miscellaneous projects which, though desirable in themselves, are not essential at this time. The expenditure in these categories is now running at £150 million a year.

Lending by local authorities on mortgage for house purchase has trebled in England and Wales in the last five years, and in 1964-65 reached £180 million. With the co-operation of the local authorities this will be restricted to the average of the three years ended 31st March, 1965, namely, £130 million.

The House will recall that last spring I undertook to review the swollen programmes of public expenditure left behind by our predecessors. This review is now complete. As I forecast before the election, the examination revealed that it would not be possible to carry out all the programmes we inherited within the limits of our resources until the necessary rate of growth of production has been achieved. We have, accordingly, reshaped the total programme and I can inform the House that from now on expenditure will be kept to the level that we as a nation can afford. I am giving instructions to Departments that the 1966-67 Estimates shall be drawn up within a limit which has been determined for each Department within the agreed total. . . .

Extract from a Statement by the Chancellor of the Exchequer

on 8th February, 1966

[O.R. Cols. 214-215]

[Mr. Callaghan]

On 27th July last, I announced the deferment of certain programmes affecting public investment and expenditure. These measures have achieved their purpose. In particular, the rate of expenditure on capital projects has been appreciably reduced. I estimate that, in the six months since the arrangements were announced, about £200 million worth of capital projects have been deferred for six months. I am grateful to all those who have made the result possible. There can be no doubt that this deferment has reduced the pressure of demand below the excessively high level which it would otherwise have reached, has reduced the load on the building industry, and has contributed to the improvement in our balance of payments.

The Government now propose to replace the deferment of individual projects by the more normal system of control by expenditure limits. Under the new arrangements, revised annual expenditure limits are being fixed in such a way that they will in general be no greater than they would have been under the deferment arrangements. But Departments will now be free to reprogramme their investment. The limits within which Government Departments will work will apply both to their own spending and in their control of capital expenditure programmes by local authorities. As before, housing, schools, hospitals, and projects in development districts will be unaffected. Estimates for 1966-67 are being prepared on this basis.

Circulars will be sent to local authorities, as necessary, notifying them of the new arrangements. Loan sanction and grants for miscellaneous local authority projects outside the main programmes will continue to be given only for projects which are urgently required.

APPENDIX II

TABLE 1

Public sector expenditure⁽¹⁾ by function⁽²⁾ (excluding nationalised industries, etc.) £ million

	1964-65		1965-66 ⁽³⁾	1969-70
	Out-turn at out-turn prices ⁽⁴⁾	1964 estimate at 1965 Survey prices ⁽⁵⁾	Estimate at 1965 Survey prices	
Main programmes:				
Defence Budget	1,918 ⁽⁶⁾	2,073	2,134	2,075 ⁽⁶⁾
Roads	393	406	426	575
Public housing investment	539	519	571	691
Housing subsidies, etc.	147	153	164	257
Police and prisons	223	230	237	281
Education (with school meals and milk)... ..	1,472	1,459	1,574	1,923
Health and welfare (with welfare foods)... ..	1,213	1,238	1,316	1,529
Benefits and assistance (with family allowances)	2,045	2,120	2,379	2,920
TOTAL	7,950	8,198	8,801	10,251
Other programmes:				
Aid programme	179	181	196	} 2,944
Other overseas expenditure	92	98	101	
Railways and waterways deficit grant	123	117	106	
Agricultural support	261	316	293 ⁽⁷⁾	
Other assistance to industry, transport and agriculture	226	271	299	
Industrial research and research councils	133	155	159	
Environmental services ⁽⁸⁾	594	559	685	
Tax collection and other financial administration	122	127	133	
Other	807	778	803	
TOTAL	2,537	2,602	2,775	2,944
Contingency allowance	—	—	—	100
GRAND TOTAL	10,487	10,800	11,576⁽⁹⁾	13,295

(1) For the purposes of Tables 1, 2 and 3 public expenditure is defined as in paragraphs 6 to 8 of the main text. The total is that which the Government decided to contain within an average increase of 4½ per cent a year at constant prices in the period 1964-65 to 1969-1970.

(2) The expenditure shown for each function is that of Great Britain spending authorities. The expenditure of Northern Ireland spending authorities is included in the last item.

(3) Estimates of summer 1965 at prices related to the Budget Estimates of 1965-66. This price basis is used for the 1969-70 figures also and is called "1965 Survey prices".

(4) The figures for out-turn in 1964-65 agree with those in the table at the end of the 1965 Blue Book on National Income and Expenditure showing the "Treasury analysis of public expenditure", the difference in total being capital formation of nationalised industries, etc.

(5) These are estimates for 1964-65 made for the Government's first analysis from which the "4½ per cent" decision was taken, adjusted to 1965 Survey prices (see note (3) above).

(6) The out-turn for 1964-65 is after deductions of large, special receipts in respect of the handing over of military assets in Kenya and Malta. The amount for 1969-70 is the equivalent, at 1965 Survey prices, of the ceiling of £2,000 million fixed for the Defence Budget at the prices of the 1964-65 Estimates.

(7) Estimated 1965-66 out-turn is now put at £244 million. (O.R. 7th February, 1966, Cols. 25-26).

(8) Environmental services cover water supply, sewerage, refuse disposal, parks and pleasure grounds and other miscellaneous services provided by local authorities.

(9) This total does not take account of the deferment measures announced by the Government on 27th July, 1965, the effect of which is expected to be a reduction of the order of £50 million in 1965-66 (see also paragraph 60 of main text above).

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TABLE 2

Public sector expenditure by economic category⁽¹⁾
(excluding nationalised industries, etc.)

£ million

	1964-65		1965-66	1969-70
	Out-turn at out-turn prices ⁽²⁾	1964 estimate at 1965 Survey prices	Estimate at 1965 Survey prices	
Current expenditure on goods and services ...	5,506	5,735	5,906	6,575
Capital formation ⁽³⁾ ...	1,516	1,467	1,672	2,186
Subsidies ...	529	580	565	572
Current grants to persons, etc. ...	2,391	2,485	2,784	3,442
Current grants abroad ...	164	158	179	155
Capital grants to private sector ...	139	149	180	240
Net lending to private sector ...	153	130	191	
Loans to overseas governments ...	78	82	79	125
Other lending abroad ...	11	14	20	
TOTAL ...	10,487	10,800	11,576 ⁽⁴⁾	13,295

(1) See footnote (1) to Table 1.

(2) See footnote (4) to Table 1.

(3) Gross domestic fixed capital formation and increase in value of stocks.

(4) See footnote (9) to Table 1.

Current expenditure on goods and services covers all direct current expenditure on goods and services, including wages and salaries, by the central government and local authorities. All current expenditure on the National Health Service, net of revenue from charges raised, is included. Current expenditure on goods and services also includes defence expenditure on fixed assets (other than married quarters, ordnance factories and other items with a potential civilian use) and building and construction expenditure overseas.

Capital formation comprises all expenditure on fixed assets (with the exceptions noted in the immediately preceding paragraph), net of the proceeds from the sale of assets, by the central government, local authorities and certain other public corporations; it also comprises an allowance for the increase in the value of stocks, and in this respect differs from gross domestic fixed capital formation.

Subsidies include the deficit grant paid to the British Railways and Waterways Boards, all subsidies in support of agriculture and the housing subsidies paid by the central government and local authorities.

Current grants to persons, etc. comprise a wide variety of current transfer payments of which benefits and assistance paid to residents of the United Kingdom under the National Insurance and related schemes form the largest single item. Also included are awards to students, school meals (net of parental contributions) and school milk, and grants in support of the current expenditure of the universities, voluntary schools and other private non-profit-making institutions.

Current grants abroad consist for the main part of grants to overseas governments under the aid programme. Expenditure on certain United

Kingdom-based institutions whose activities are directed to the needs of countries overseas is treated as grants abroad. Military aid, subscriptions to international organisations and benefits and assistance paid to residents overseas are also included.

Capital grants to the private sector include building grants to universities and other educational institutions, together with grants in the form of assistance to industry under, for example, the Local Employment Acts and housing improvement grants by local authorities.

Net lending to the private sector consists mainly of loans, net of repayments, by local authorities for house purchase. Ship-building loans (net) are also included.

Loans to overseas governments. The coverage of this item is self-explanatory.

Other lending abroad comprises drawings from the United Kingdom subscriptions to the International Development Association and loans in support of projects sponsored by the Commonwealth Development Corporation.

TABLE 3
Public sector expenditure by spending authority⁽¹⁾
(excluding nationalised industries, etc.)

£ million

	1964-65		1965-66	1969-70
	Out-turn at out-turn prices ⁽²⁾	1964 estimate at 1965 Survey prices	Estimate at 1965 Survey prices	
Central government:				
Votes (G.B.)	5,165	5,489	5,632	} 8,649
National Insurance Funds (G.B.)... ..	1,543	1,609	1,832	
Other ⁽³⁾	316	355	353	
Local authorities ⁽³⁾	3,392	3,258	3,639	4,392
New Town Corporations (G.B.)	48	63	68	97
Other ⁽³⁾	23	26	52	157 ⁽⁴⁾
TOTAL	10,487	10,800	11,576⁽⁵⁾	13,295

(1) See footnote (1) to Table 1.

(2) See footnote (4) to Table 1.

(3) Includes expenditure of Northern Ireland spending authorities.

(4) Including contingency allowance.

(5) See footnote (9) to Table 1.

The figures shown in this table represent final expenditure by the various spending authorities, including transfer payments outside the public sector but excluding all transfers between authorities. Thus the actual payments of social security benefits are included against either central government Vote-borne (Supply) expenditure or expenditure by the National Insurance Funds, depending upon the type of benefit; the Exchequer contribution to the Funds is however excluded, since this ranks as an internal transfer within the public sector. Similarly all expenditure by local authorities, irrespective of the way

in which it is financed, appears against local authorities, while grants by the central government to local authorities (estimated at £1,300 million in 1965-66) are excluded. It follows therefore that, because of these transfers and various other transactions between Departments and the Exchequer, the element of total public expenditure by the central government on Votes will differ from the total of the published Estimates. For a reconciliation of total Estimates with total public expenditure see Table 4.

TABLE 4

Reconciliation between total Supply expenditure (Estimates) and total public expenditure

£ million

	Out-turn at out-turn prices ⁽¹⁾	Estimate at 1965 Survey prices
	1964-65	1965-66
1. Total Supply expenditure (net Votes-G.B.)	6,446	7,134
<i>less</i> grants, etc. to local authorities	-1,195	-1,305
<i>less</i> Exchequer contribution to National Insurance Funds	-233	-305
<i>plus</i> National health contributions	163	164
<i>less</i> other Vote payments not included as part of total public expenditure <i>plus</i> other Vote receipts not deducted	-16	-56
2. =Vote element in total public expenditure	5,165	5,632
3. Central government expenditure not on G.B. Votes:		
(a) Consolidated Fund loans, etc.	169	193
(b) National Insurance Funds (G.B.)	1,543	1,832
(c) Northern Ireland central government	147	160
4. Expenditure of local authorities (U.K.):		
(a) Current expenditure	2,113	2,274
(b) Gross domestic fixed capital formation	1,141	1,207
(c) Other capital expenditure	138	158
5. Expenditure of certain public corporations (mainly New Towns, but excluding nationalised industries, etc.):		
(a) Gross domestic fixed capital formation	66	104
(b) Other capital expenditure	5	16
6. TOTAL PUBLIC EXPENDITURE COVERED BY THE "4¼ PER CENT" DECISION	10,487	11,576 ⁽²⁾
7. Capital formation of nationalised industries, etc. ⁽³⁾	1,186 ⁽⁴⁾	1,282
8. TOTAL PUBLIC EXPENDITURE	11,673	12,858

(1) The figures for out-turn in 1964-65 agree with those in the table at the end of the 1965 Blue Book on National Income and Expenditure showing the "Treasury analysis of public expenditure".

(2) See footnote (9) to Table 1.

(3) Gross domestic fixed capital formation and increase in value of stocks.

(4) This figure is not entirely consistent with the figures in Table 5 because of the use in that table of later information.

TABLE 5

Investment⁽¹⁾ of nationalised industries, etc.⁽²⁾

£ million

	Out-turn at out-turn prices	Estimate at 1965 Survey prices		
	1964-65	1965-66 ⁽³⁾	1966-67 ⁽³⁾	1969-70
National Coal Board	90 ¹	90 ⁵	93	85 ⁽⁴⁾
Gas Council	90 ¹	112 ¹⁰	151 ⁺⁹	145 [✓]
Electricity Council ⁽⁵⁾	572	624	695 ¹¹⁵	575
South of Scotland Electricity Board	634 44	691 52	756 51	638 52
North of Scotland Hydro-Electric Board	18	15	10	11
British European Airways	15 [✓]	19 [✓]	19 ⁺⁵	19 ⁺⁵
British Overseas Airways Corpora- tion	27 [✓]	12 ⁴	15 ⁺⁶	20 ⁺⁹
British Railways Board ⁽⁶⁾	111 ⁺⁵	119 ⁵	118 ⁶	120 ⁺²
London Transport Board ⁽⁶⁾	21 ⁺¹	23 ¹	23 ⁺¹	14 ⁺¹
British Transport Docks Board ⁽⁶⁾	5 ⁺²	8 ¹	14 ²	18 [✓]
British Waterways Board ⁽⁶⁾	1 [✓]	1 [✓]	1	2 [✓]
Transport Holding Company ⁽⁶⁾	14 [✓]	20 ¹	22 [✓]	19 [✓]
Post Office	180 ¹²	210 ²⁸	250 ⁺³	326 [✓]
TOTAL NATIONALISED INDUSTRIES	1,188⁶	1,305⁶⁵	1,462	1,406
British Broadcasting Corporation...	12	11 ⁶⁵	13	10
Independent Television Authority...	1	1	1	2
Covent Garden Market Authority	—	15 ⁷⁰	1	9
GRAND TOTAL	1,201	1,317	1,477	1,427

(1) Investment is defined as expenditure on fixed assets before deducting proceeds from the sale of assets.

(2) This table is based on the 1965 investment review and incorporates developments and Government decisions since the publication of the National Plan.

(3) The figures in these columns take account of the deferment of expenditure called for in the Chancellor's statement of 27th July, 1965 (see Appendix I and paragraph 61 of main text above).

(4) This figure is the industry's estimate only—see paragraph 13 of the White Paper on the Finances of the Coal Industry. Cmnd. 2805 (November 1965).

(5) Includes expenditure on nuclear fuel.

(6) The financial year for these authorities is the calendar year. The figures in this table have therefore been adjusted.

TABLE 6

Domestic capital expenditure⁽¹⁾
(including nationalised industries, etc.)

£ million

	Out-turn at out-turn prices	Estimate at 1965 Survey prices		
	1964-65 ⁽²⁾	1965-66 ⁽³⁾	1966-67 ⁽³⁾	1969-70
Defence Budget	23	35 ⁺²	36	35
Roads	208	216 ⁻⁹	242	364
Housing (including improvement grants)	553	590 ⁰	615 ²⁰	717 ⁻²⁶
Police and prisons	24	22 ²	26	33
Education	261	253 ⁶	266	315 ⁷⁷
Health and welfare	104	116 ¹²	114	154
Nationalised industries ⁽⁴⁾	1,184 ⁽⁵⁾	1,305	1,462	1,406
British Broadcasting Corporation, Independent Television Authority, Covent Garden Market Authority ⁽⁴⁾	12 ⁽⁵⁾	12 ⁸⁴	15	21
Other... ..	669	795 ²⁴	807	826
TOTAL DOMESTIC CAPITAL EXPENDITURE	3,038	3,344	3,583	3,871
less sales of fixed assets	-82	-87	-73	-73
	2,956	3,257	3,510	3,798
of which:—				
Gross domestic fixed capital formation:				
Central government	292	327 ¹⁴	356	3,553
Local authorities	1,141	1,184 ⁴³	1,267	
Nationalised industries, etc. ⁽⁴⁾	1,165	1,272	1,445	
Other public corporations ⁽⁴⁾	66	102	118	
TOTAL	2,664	2,885	3,186	3,553
Capital grants to private sector	139	181	182	245
Net lending to private sector	153	191	142	

(1) Domestic capital expenditure is defined as expenditure on fixed assets (before deduction of proceeds from the sale of assets) together with grants and net lending to the private sector (e.g. universities) for capital purposes. It thus provides a measure of the total of domestic asset-creating expenditure by the public sector.

(2) Based on information available at time of publication of the 1965 Blue Book on National Income and Expenditure and hence consistent with the table at the end of the Blue Book showing the "Treasury analysis of public expenditure" by financial years and with Tables 1-4 and Table 7 of this White Paper.

(3) The figures in these columns take account of the deferment of expenditure called for in the Chancellor's statement of 27th July, 1965. (See Appendix I and paragraphs 60 and 61 of main text above).

(4) The estimates for these items are based on the 1965 investment review and incorporate developments and Government decisions since the publication of the National Plan.

(5) The figures in Table 5 for these items differ slightly because of the use in that table of later information.

APPENDIX III

TABLE 7—Receipts and expenditure of the public sector, 1964–65⁽¹⁾ (including nationalised industries, etc.)

£ million

Receipts		Economic classification of expenditure		Functional classification of expenditure ⁽²⁾	
CURRENT INCOME		CURRENT EXPENDITURE		Defence Budget 1,918	
Taxes on income	3,688	Current expenditure on goods and services ⁽³⁾ :		Other defence expenditure (including civil defence)	131
National insurance contributions	1,291	Central government	3,583	External relations	271
National health contributions	168	Local authorities	1,923	Roads and transport	567
Taxes on expenditure, central government	3,521	Subsidies:		Employment, industry and trade	109
Local rates	1,120	Central government	488	Industrial research and research councils	133
Gross trading surpluses ⁽⁴⁾ :		Local authorities	41	Agriculture, fisheries and forestry	327
Central government and local authorities	101	Current grants to persons, etc.:		Housing and environmental services	1,405
Public corporations (including nationalised industries, etc.)	940	Central government	2,242	Libraries, museums and arts	46
Gross rental income	630	Local authorities	149	Law and order and fire services	322
Interest, dividends, etc.	224	Current grants abroad	164	Education	1,381
		TOTAL CURRENT EXPENDITURE, EXCLUDING DEBT INTEREST	8,590	Health and welfare	1,175
		Debt interest	1,379	Children's services	315
		TOTAL CURRENT EXPENDITURE	9,969	Benefits and assistance	1,898
		Current surplus ⁽⁴⁾	1,714	Financial administration and common services	239
TOTAL	11,683	TOTAL	11,683	Miscellaneous services	37
				Northern Ireland	232
CAPITAL RECEIPTS		CAPITAL EXPENDITURE		Statistical adjustments	-19
Current surplus ⁽⁴⁾	1,714	Gross domestic fixed capital formation:		TOTAL, EXCLUDING CAPITAL FORMATION OF NATIONALISED INDUSTRIES, ETC.	10,487
Taxes on capital	299	Central government	292	Gross domestic fixed capital formation of nationalised industries, etc. ⁽⁷⁾	1,165
Capital transfers	10	Local authorities	1,141	Increase in value of stocks of nationalised industries, etc.	21
Loan repayments from overseas governments	24	Nationalised industries, etc.	1,165	TOTAL PUBLIC EXPENDITURE	11,673
Proceeds of iron and steel disposals	18	Other public corporations	66		
Receipts from certain pension "funds" (net)	54	Increase in value of stocks:			
Adjustments for accruals of:		Central government	17		
Taxes on expenditure	-16	Public corporations (including nationalised industries, etc.)	21		
Subsidies	—	Capital grants to private sector	139		
Miscellaneous	67	Net lending to private sector	153		
Net balance ⁽⁵⁾ :		Loans to overseas governments	78		
Central government	285	Drawings from U.K. subscriptions to international lending bodies	8		
Local authorities ⁽⁶⁾	602	Net lending abroad for private industry, etc.	3		
Public corporations ⁽⁶⁾	26				
TOTAL	3,083	TOTAL	3,083		
		Current expenditure, excluding debt interest	8,590		
		Capital expenditure	3,083		
		TOTAL PUBLIC EXPENDITURE	11,673		

(1) Provisional out-turn, see footnote (1) to Table 4.

(2) For greater detail, see table at the end of the 1965 Blue Book on National Income and Expenditure showing the "Treasury analysis of public expenditure." The classification differs in some respects from that in Table 1 above.

(3) Excludes current expenditure on goods and services on operating account of public corporations and other public enterprises.

(4) Before providing for depreciation or stock appreciation.

(5) Equal to net borrowing, less increase in foreign reserves.

(6) Excludes net borrowing from central government.

(7) The definition differs from that of the figures of domestic capital expenditure for nationalised industries in the top half of Table 6. In the figures in this table sales of fixed assets have been deducted in accordance with the national accounting definition of gross domestic fixed capital formation.

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