

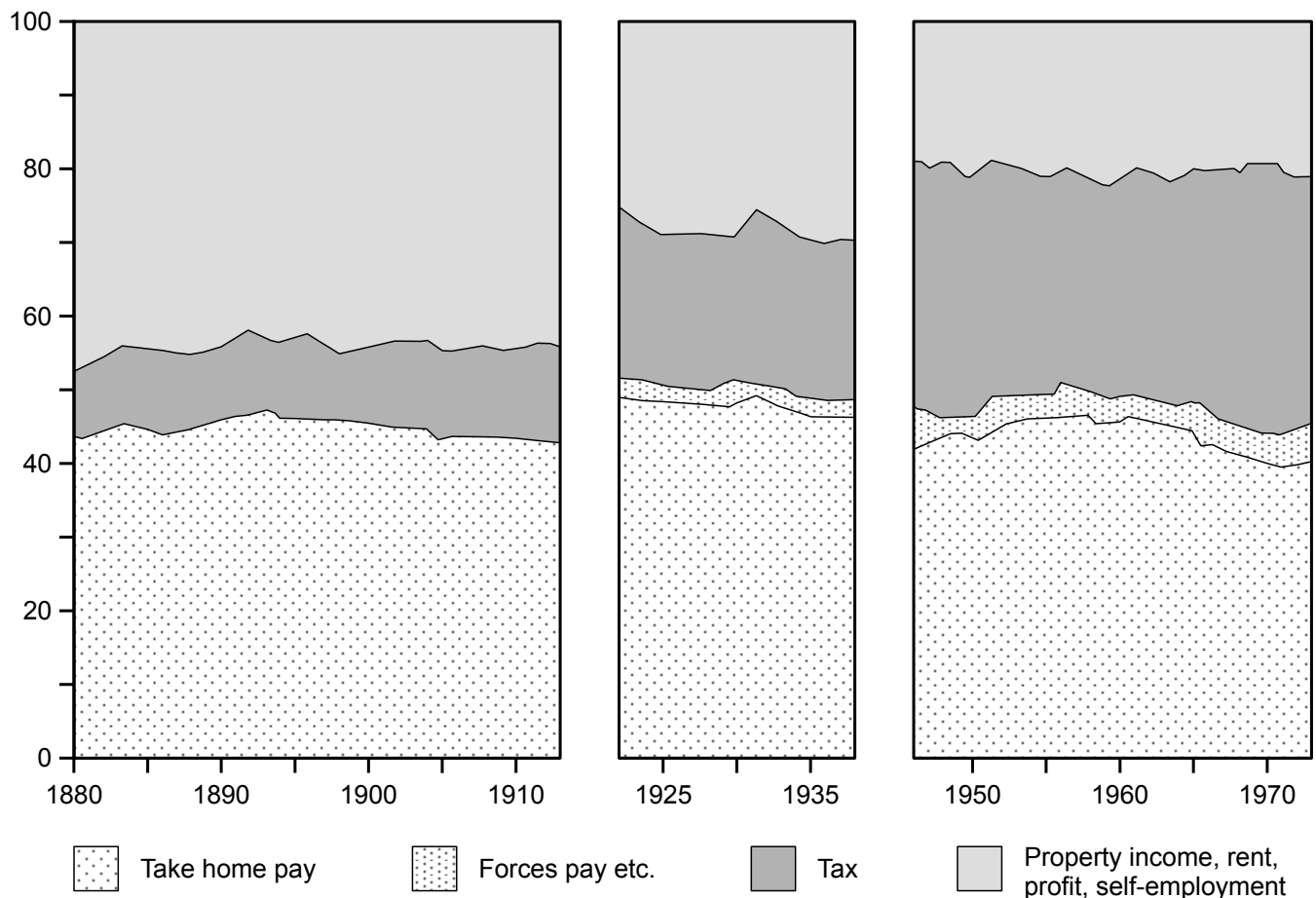
Economic Commentary

By Ronald Burgess

“Post-tax trading profits in the U.K. have been near non-existent since 1970 and in the face of ever rising taxation have been on a declining trend for over 60 years.”

The new British Government is surrounded by near insoluble economic problems, the result of past mistakes. But the immediate danger arises from the possibility of an economic depression and its associated heavy unemployment. That the company sector of the economy is now insolvent has become a talking point. But the cause and long term nature of the malaise is not yet appreciated. After allowing for stock appreciation and capital consumption, post-tax trading profits arising in the U.K. have been near non-existent since 1970 and in the face of ever rising taxation have been on a declining trend for over 60 years. The new arrangements for company taxation and the effects of inflation on stock appreciation are no more than final straws and the removal of these additional burdens would have little noticeable effect.

THE NATIONAL CAKE



The proposals currently being canvassed would achieve no more than delay the day of reckoning for a few fortunate companies. The present situation demands a cut in the flow of cash to the government from all employers of labour and this cut must be effective before the first quarter of 1975.

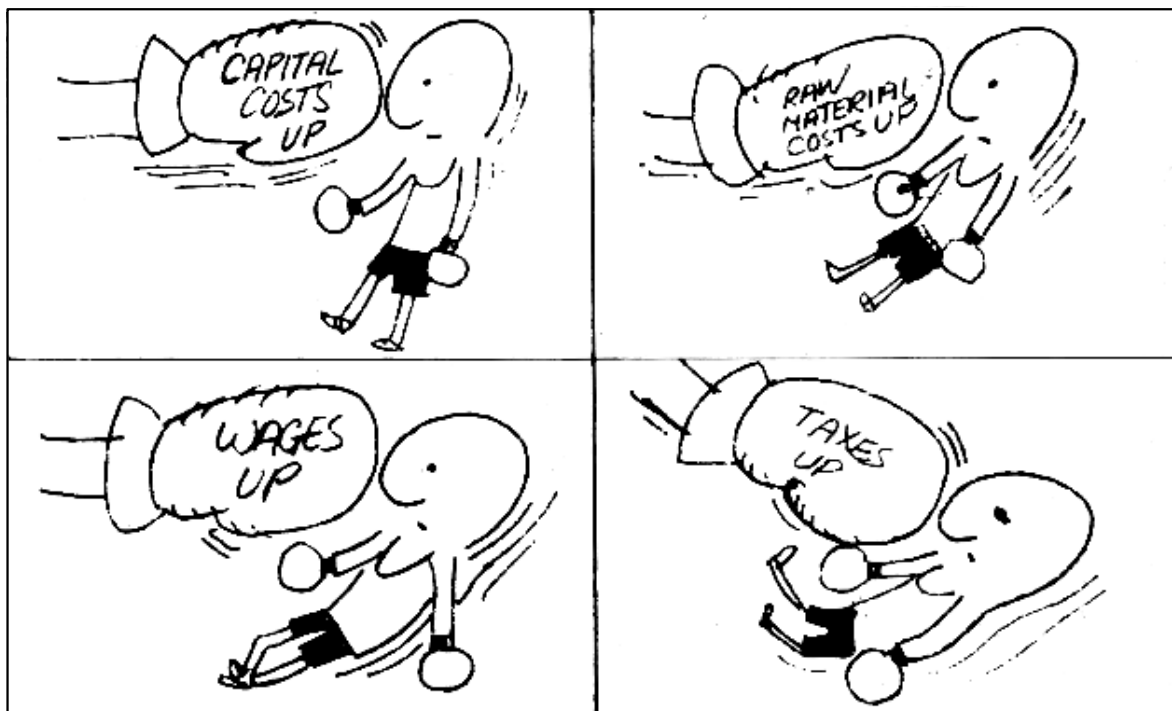
The level of unemployment depends upon the demand for employees by employers. The strength of this demand is determined by price, reckoned as employers' labour cost as a percentage of the Gross Domestic Product, and profitability, reckoned as post-tax net trading profits also as a percentage of GDP.

Whilst, in a broad sense, the above may be widely acceptable what is not generally recognised is that the changes in the price variable are mainly the result of changes in taxation and that these changes take some twenty months to affect demand. Changes in the profit variable affect demand within four to five months. Contrary to economic mythology, the price variable declined by about 5 per cent over the three years following a peak early in 1971. The main reasons for this decline were the tax reductions in April 1973, particularly SET.

From the price of labour the prospects for a stable level of employment remain good until the autumn of 1975 since the rising trend which has now re-asserted itself will not affect demand until the winter of 1975/76. Unfortunately the quicker acting profit variable, which has an inverse relationship with demand, has also been falling during the past eighteen months and suffered a catastrophic decline during the first six months of this year. Already falling profits have whittled away the improvements to employment prospects that accrued from a declining price variable following Mr. Barber's tax cuts.

If the processes now in motion are allowed to proceed unchecked the demand for employees will be measurably contracting early in the new year and the stage will then be set for massive unemployment during the following winter.

Although it may be agreed that the government must take immediate action to restore profitability and to stabilise employers' labour costs to avoid disaster, the vital question is how to achieve the objective speedily and without intensifying the multitude of other economic difficulties. Any proposals involving an increase in government spending will create more problems than will be resolved. Any proposals involving tax reductions must not only be speedily effective but, bearing in mind the magnitude of the current borrowing requirement, they must be so directed as to create opportunities for reductions in government spending.



The specific proposals for a cut in corporation tax and an alteration in the tax laws to allow for the effects of inflation on stock appreciation are too slow acting to meet present needs. A relaxation in price control might speedily improve profitability and restore some vigour to the economy but in isolation the side-effects of this proposal could, in the short term, create insuperable difficulties. However a study of recent history indicates that the abolition of SET not only reduced the price of labour but had the direct effect of improving profitability.

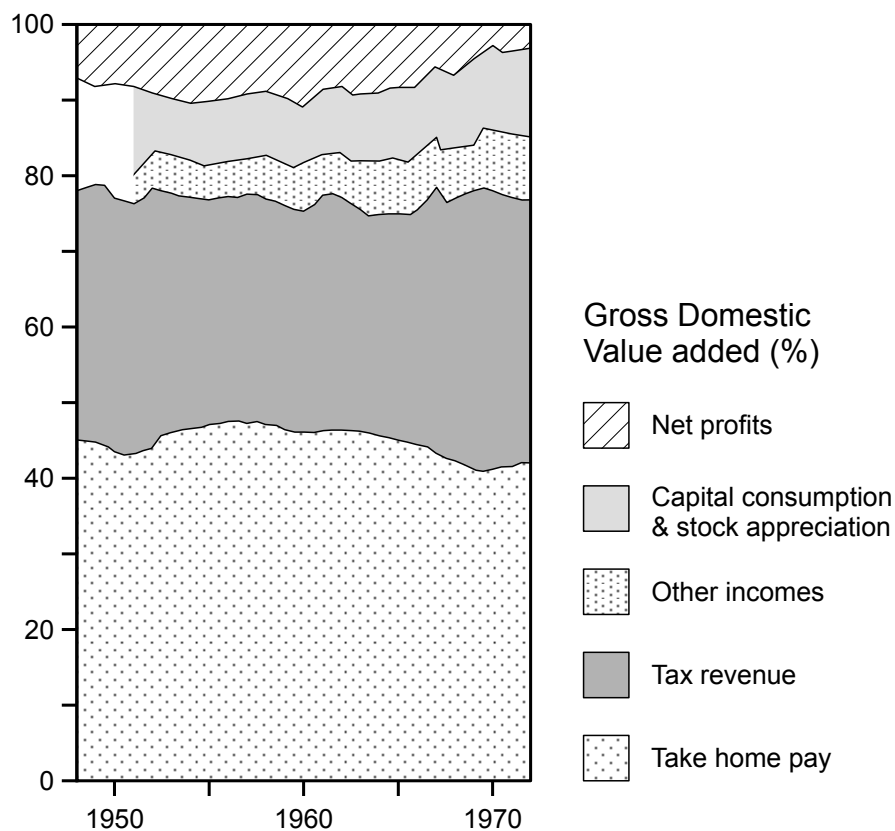
In today's context a significant cut in the employers' national insurance contribution would have the same effect. Such action by the Exchequer would reduce the cash outgoings of all employers within a few weeks and thus improve the country's immediate prospects. Further by directly reducing the price of labour *now* he would be improving employment prospects for *next* winter and thus give time for any longer term policies to take effect.

The greatest benefits from a cut in employers' national insurance contributions would accrue to labour intensive industries, employers located in the less prosperous regions and in particular to local authorities.

It is these sections of the community whose needs are greatest and who already account for a sizeable proportion of government expenditure on subsidies and grants. By relieving their direct tax burden, opportunities would be created for significant reductions in central government expenditure.

As regards inflation a fall in employers' labour cost and improved profitability must be expected to at least ease the pressure. By the same token the competitiveness of British industry in international markets would improve whilst the extension of profitable locations would enable such demand to be met within the period under consideration.

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Editor's note: Anthony Barber was Chancellor of the Exchequer from 25th July 1970 to 4th March 1974 under the Conservative Prime Minister Edward Heath. From 2nd April 1973, Selective Employment Tax (SET) was abolished and Value Added Tax (VAT) replaced the former Purchase Tax. Following the election of a Labour government in February 1974, Anthony Barber was replaced by Denis Healey, who held the office from March 1974 until 4th May 1979. By the end of 1975, total government spending had risen to more than 45% of Gross Domestic Product.