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THE PROBLEM OF BUDGETARY REFORM

BY

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I

THE PRESENT STATE OF BUDGET ACCOUNTING

1. THE object of this essay is to discuss certain issues of principle which arise in connexion with the measurement of a budget surplus. The urgency of this problem needs no emphasizing; it was made abundantly apparent by the discussions, in the Press and in Parliament, which preceded and accompanied the presentation of the 1948 Budget. For the budget year 1947-8, the public accounts (classified in the manner which had become habitual) showed the unprecedented surplus of £636 millions; but this surplus was not available for redemption of debt, being in fact offset by payments, almost exactly equal in amount, which were placed (with parliamentary sanction) 'below the line', so that they did not have to be included in the budget account proper. As this situation began to declare itself, commentators and critics became exercised in their minds about the principles on which these exclusions had been fixed; could the enormous 'surplus' be taken to have any intelligible meaning? Then, in his budget speech the Chancellor declared his own conversion to the side of the doubters; he admitted that all was not well with the conventional reckoning, and put forward a provisional 'alternative classification' as a suggested improvement.¹ But the principles on which the 'alternative classification' was based were not set out in any authoritative manner; it was evidently not intended to be taken as a fully reformed statement, which had authority behind it; it was merely intended to provoke discussion. To that discussion the present paper is a contribution.² In its course I shall indicate my own preferred classification of the account; but my

¹ The 'conventional form of accounts' and the 'alternative classification', as given for the financial year 1947-8, are reprinted in Tables i and 2, of the Tabular Appendix.

² I should like to make an acknowledgement to officials in the Treasury and other government departments for the information with which they have provided me and for the helpful criticisms which they have offered. My chief other acknowledgements are to my colleague, Mr. D. N. Chester, and to my wife, without whose special knowledge of this field I should never have dared to attempt a study of this character.

main object is to dig a little deeper, to inquire how the trouble has arisen, what are the principles which a generally satisfactory classification ought to satisfy, and how that classification can be made to fit in with general principles of budgetary policy, including in these both the traditional principles and the new ideas on the subject which in recent years have become so generally accepted.

2. The definition of a budget surplus has two aspects, which may be called the accounting aspect and the economic aspect. From the accounting aspect, the problem is one of maintaining order in the accounts of the government itself; from the economic aspect, it is one of getting a sensible relation between the accounts of the government and the accounts (actual or estimated) of the rest of the national economy. Now, although I write as an economist, I do very firmly maintain that in this particular matter the accounting aspect comes first and the economic aspect second. The first objective ought to be the ordering of the government's accounts as such; only when that has been done can the further problem, in which economists are mainly interested, be tackled satisfactorily. If we could once agree upon the principles by which the government's accounts should be ordered, the accounts of the National Income and Expenditure could be adjusted to fit; but if we start from the other end, beginning from the economic requirements, we may easily be endeavouring to fit the government accounts into a framework with which it is difficult, and from their own point of view may be undesirable, for them to conform.

3. Looking at the matter from the accounting side, I think that the trouble has largely (though by no means wholly) arisen from a most important change in the accounting magnitude which people feel that they want to measure. Traditionally a surplus was a surplus of receipts over payments; that is to say, during a year in which the government had a surplus it was diminishing its net indebtedness—either it was actually redeeming debt, or it was accumulating a money balance out of which it could redeem debt. The whole traditional system of public accounts was built round this simple idea. It had great advantages, to which I shall be referring later; but it is surely time for us to recognize that by now it is becoming quite out of date. **As**

long as the functions of the State were purely administrative, there was a lot to be said for the traditional measure; but the State is now developing economic functions on such a scale that the traditional measure simply will not do.

4. Let me take a simple and strong illustration. Suppose that the Ministry of Food buys £100 millions worth of food-stuffs during the year 1948-9, which it does not sell during that year, but adds to stock; and then it disposes of that stock at a profit of £5 millions during the year 1949-50. This is a purely trading transaction which business accounting would deal with by debiting the £100 millions to capital account in the first year, setting off £100 millions of the selling price against fall in stocks in the second year, and taking £5 millions profit in the second year. The traditional system of public accounting would reckon the original £100 millions as expenditure in the first year, when it might well be sufficient to turn a budget surplus into a deficit; it would then reckon £105 millions as receipts in the second year, when it might well turn a deficit into a surplus.

5. Against this consequence of the traditional method public opinion is (I think rightly) revolting. For as long as the traditional method is followed, every expansion of public enterprise will make for apparent deficits; every retreat will show itself in an apparent surplus. And whether one is in favour of advance or of retreat, it is easy to agree that changes of this sort ought not to be accounted in this way. The trading activities of the government are now large enough to become a dominating feature of the budget accounts if the traditional method is followed. Their swings will simply mask what is happening on current account, so that it will be impossible to make sense of the accounts in the old way. Surely the time has come when we are going to have to do something about it.

6. And there is another aspect of the same trouble. In order to prevent this tendency for the extension of public enterprise to produce budget deficits, there is a noticeable inclination to exclude some public enterprises (in particular, the nationalized industries) from the budget altogether. Of course this exclusion is largely motivated by the desire to give financial autonomy; as things now are, the case for such autonomy is often very strong.

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But it can hardly be denied that the results of undertakings for which the State is responsible are relevant to the budget. *Ad hoc* exclusion of particular State activities is a notorious danger to good budgeting; if the budget only covers a part of the State's responsibilities it is bound to deteriorate in effectiveness as an instrument of policy.

7. We shall see, as we go on, that it is these matters which are the really fundamental issues which are raised by the question we are discussing. But at the present moment there are others which are quantitatively quite as important. It will be convenient to get some of these other matters out of the way before returning to the central issue.

8. The inwardness of these other complications can best be approached by reminding ourselves of the important administrative consequence of the traditional system of budgeting. So long as one is only interested in the difference between receipts and payments, the administrative problem is limited to discovering a means of ascertaining what the balance of receipts and payments really is. Even that, in an immense organization, is no simple problem. The British Government consists of many departments, each of which has long had some distinct financial existence; the problem of financial control over the departments has presented itself from early times. In the absence of financial control, each department would tend to accumulate debt of its own, for it could borrow on the general credit of the government; and it would spend such funds quickly or slowly as suited it best. In such conditions, it would be impossible to have any general financial policy, because the expenditure of the departments could not be controlled, and might not even easily be ascertained. The traditional way of overcoming this difficulty (it was the basis of the financial reforms of Pitt and Gladstone) has been to keep the departments in close financial dependence on the Exchequer. The departments are, in principle, not allowed to borrow outside nor to give credit outside; all their funds must be acquired through the Exchequer and all unspent balances must be returned to the Exchequer. So long as this principle is adhered to rigorously, it does not only achieve the desired financial control; it also simplifies the accounting problem immensely. If the depart-

ments are neither allowed to accumulate debt of their own, nor to give credit, nor to accumulate unspent balances, their expenditure must be exactly equal to their receipts from the Exchequer. Thus the expenditure from the Exchequer will exactly match the expenditure of the government as a whole. It is only necessary to calculate the surplus on the Exchequer account, and one has automatically calculated the surplus on the accounts of the government as a whole. The department accounts always balance, so that the Exchequer account mirrors the consolidated account of the whole government, which need not itself be set out explicitly.

9. That is the traditional system; if it were strictly enforced it would offer a very neat solution to a large part of the government accounting problem. But as things are now, it is not strictly enforced; and it is distinctly doubtful how far it is possible to enforce it at all strictly in modern conditions. In order for it to work perfectly, it is necessary that the departments should return all unspent balances to the Exchequer *at the end of each financial year*; for only so will their out-payments during the year match their net receipts from the Exchequer in the year. But the departments of a modern government work on much too vast a scale for it to be possible to clear them out completely at a given date; they have to be left with working balances. Yet once this concession—this inevitable concession—is made, the whole system is in danger. The Treasury may, in the end, recover unspent balances as intended, but it is likely to recover them *in the wrong year*. Over a sufficient period of years, the balance of receipts and payments remains correct; but the account in any particular year may be gravely distorted.

10. So long as the rate of expenditure by the departments is not varying much from year to year, this distortion will be small; and careful administration (which the Treasury does undoubtedly exercise) can keep it practically negligible. But when there are large changes in the rate of expenditure (as must happen in the course of a war and of its aftermath) the situation tends to become unmanageable. In the stress of war-time the lags in repayment become greater than usual, and the errors mount up. It was precisely for this reason that the 1947-8 accounts included no less a sum than £112 millions as receipts

from 'Vote of Credit balances'. In terms of the accounts of the Exchequer these 'clawed back' balances are a perfectly genuine receipt; but they are simply a transfer from another government department which has lost every penny that has been gained by the Exchequer. They are not a source of revenue for the government as a whole. There is nothing to be said for bringing them in to the revenue account of the government, as soon as we start thinking in terms of the accounts of the government as a whole, not in terms of the Exchequer account in a narrow sense.¹

11. A second complication, arising even more directly out of war finance, is what may be called the 'Quasi-Debt'. In earlier wars there was a clear line between receipts from taxation and receipts from borrowing; it was upon this clear line that the whole concept of a surplus or deficit was based. In the 1939-45 war this clear line became blurred as a result of the introduction of compulsory lending. Income-tax payments, due to be refunded as 'post-war credits', and excess profits tax payments, likewise due to be refunded, were something between a tax and a loan, not fitting easily into the accounts under either heading. A case could have been made for treating them in either way, but once that way had been chosen, it should have been followed through consistently. On the whole, the tendency was to treat the receipts from such compulsory loans as tax receipts, as a source of revenue not leaving behind it any formal obligation which would appear as an item in the National Debt. If this principle is followed, it is logical to treat the repayment (when it comes) as a voluntary payment, which must be included in the expenditure of the year in which it occurs. But on the other hand, it is possible to make out a case for treating the compulsory loans as borrowing, not as taxation. It is quite a good case, though this procedure would perhaps have come more naturally if interest had been paid to the 'lenders' (as the Canadians did, but we did not). On this alternative the receipts which were due to be refunded should have been regarded as borrowing, not as tax revenue; the resulting obligation should have appeared as an item in the National Debt; then, when the repayments came to be made,

¹ See below, pp. 32-6 for a further discussion of this point.

they could properly have been excluded from expenditure and could properly have been reckoned as an application of surplus to debt redemption.

12. In fact, the authorities appear to have tried to have the best of both worlds. When the receipts first came in they were treated as tax revenue. When the refunds came to be made they appeared 'below the line'—though in an *alternative classification' the refund of post-war credits is reckoned as expenditure on revenue account, excess profits tax refunds still being treated as a capital item. Having begun by assimilating the compulsory lending to taxation, it would have made for cleaner accounting if the same principle had been observed throughout, and all the refunds had been treated as current expenditure.

13. These are relatively special problems; myJ^rd complication brings us back towards the central issue. It was an essential feature of the traditional system that departments should not be able to secure funds excepting through the Exchequer; this implied that they should not be able to borrow outside, and ought (one would have supposed) to imply that they should not lend outside. For either borrowing or lending by the departments infringes the central control over the net indebtedness of the government. Here again it becomes evident from a study of the published accounts that there have been wide divergences from the traditional principles. Some of these divergences are, no doubt, war-time abnormalities, which may be expected to clear themselves up as time goes on; but in this case the main reason for the breakdown of the traditional practice is not of a transitory character. It is impossible to conduct trading operations without giving and receiving trade credits; the trade credits of trading departments are a form of government borrowing and lending which is not centralized in the Exchequer and which, therefore, if it develops on an extensive scale, makes nonsense of the traditional criterion for a surplus.

14. The development of Trade Credits may be illustrated by the following figures. It appears by the published *Trading Accounts (1946-47)*¹ that on 31 March 1947 the Ministry of Food owed £69 millions to trade creditors and £21 millions

¹ H. of C. Paper 34 (1947-8).

to 'other governments'; it was owed £41 millions by trade debtors and £10 millions by 'other governments', so that it had a net debt of approximately £40 millions—quite outside the regular National Debt administration. (Actually, during the year 1946-7, this net debt did not change appreciably; but presumably an appreciable change could well have occurred.) At the same date the Raw Materials Department of the Board of Trade had a balance owed to it of about £25 millions; this balance had only been equal to £10 millions a year previously, so that in this case we have £15 millions of apparent expenditure during the year 1946-7, which had in fact taken the form of a particular variety of government lending.¹

15. The nature of the problem confronting us now becomes apparent. The British Government has been conducting its affairs on the basis of a set of accounting and administrative principles which were, in their great days, a simple and efficient solution to the problem of controlling the public finances. But we have now reached a point when it is hardly too much to say that this traditional structure is in a state of ruin. The ruin is partly a result of the war—it has always been difficult to enforce the traditional principles in war-time—but to a large extent the causes lie deeper. The main reason for the collapse is the development of trading services, which will not fit into the traditional categories. The trading services are much more like businesses than they are like government departments of the traditional type; like businesses, they borrow and lend (they have to borrow and lend), and like businesses, they accumulate real assets, their stock of which rises and falls. To apply the conventions of the traditional Exchequer accounting to these trading services makes nonsense; it has been found that it

¹ It should be noticed that the *Trading Accounts*, from which the above figures are taken, are compiled on commercial principles, and are not a cash account, like accounts of most other government departments.

An indication of the variety of the credit items which are nowadays hidden away in government accounts is to be found in the note to item 85 of Table 19 of the National Income White Paper Cmd. 7371 (April 1948). This is the table which exhibits sources of central government borrowing, and the item is called 'other extrabudgetary receipts, &c.' In fact, as is evident from the note, it includes many payments as well as receipts. Among these payments we notice 'government lending included in Ordinary Expenditure'; and an allowance is made for 'increase or decrease in government liabilities to industry'.

makes nonsense. But because there has been no systematic attempt to reformulate the traditional principles to meet the new situation, the failure to fit these principles to the trading services has had a whole series of destructive consequences. On the one hand, there has been the tendency to push some of the government's trading responsibilities (in particular the nationalized industries) outside the budget altogether. Because we cannot deal with them by the traditional methods, we will not deal with them at all! On the other hand, those trading services which have not been excluded in this way have exercised a baleful influence in weakening the authority of the traditional principles in their traditional applications. Because the old system no longer makes the sense it did, there seems less and less reason to conform to the old rules. It follows as a result that just at a time when the national government is undertaking so immense a programme of new responsibilities^ its strength and authority, at the very heart of its activities, is being gravely weakened.

II

A PRACTICAL PROPOSAL

1. IN the light of this situation, it is very natural to suggest that the right procedure would be to abandon the 'old-fashioned' Treasury accounting altogether. Some of the trading services have learned to adopt up-to-date business accounting methods; why should not the whole of the government's finances be put upon a business accounting basis? It would not be at all impossible to devise a form of accounts by which the whole of the government accounts could be assimilated to business accounts; and it is true that such assimilation would offer a number of advantages. It would provide a new and authoritative set of canons for orderliness; it would enlist the experience and influence of the accountancy profession in maintaining those standards; and it would facilitate the integration of the government's accounts with those of the rest of the economy in national income calculations, with all that that implies for the smooth working of a rational employment policy. In the light of these advantages, it is not surprising that a drastic reform of this kind has seemed to many people to be the best way out of our difficulties. It seems to me, however, that there would be many disadvantages in adopting so drastic a remedy. And I think I can show that these disadvantages could be avoided, while the advantages would be retained, if we adopted a less radical solution, which I shall explain here.

2. It is indeed obvious that a revolutionary change of method is not the way, in the short run at least, to promote orderliness; when people are used to one method, the introduction of another very different method must produce a good deal of initial confusion. But the main argument against the drastic solution goes deeper than this. So far as the administrative departments of the old type are concerned, there really is not much which is wrong with the traditional system of accounting and financial control. It is their *expenditure* in the old sense which has to be controlled; and the traditional system offers as good a way of controlling their expenditure as has yet been devised. It has distinctly more relevance to their problems than

business accounting has. They are being entrusted, ultimately by Parliament, with a regular *flow* of funds which they are to distribute in appointed ways. They are not being entrusted, as the commercial company is entrusted, with a capital sum, which it is their first duty to maintain intact. The first object of commercial accounting is to watch over the capital of the business; the fact that the administrative department has no capital (or hardly any) makes commercial accounting distinctly ill-suited to its problems. The trading department, on the other hand, has, in some form or other, a capital entrusted to it; that is the reason why it is obliged to make use of commercial accounting, if it is to order its transactions satisfactorily.

3. There seems to me therefore to be a distinction, sound in principle, and not at all incapable of being translated into practice, between the systems of accounting which are proper to the administrative department and to the trading department respectively. It does indeed look as if some such distinction was in process of being evolved by experience. Would it not be the wisest plan to accept that experience and to see whether an orderly arrangement cannot be based upon it? The idea does, at least, look attractive enough to be worth following through, and seeing where it may be expected to lead. That is what I shall now proceed to do.

4. The first essential of the proposed arrangement would be that all departments of the central government," in the widest sense, should be classified as what we shall call Administrative Departments, or as what we shall call Trading Departments.¹ It is not essential to the proposal that the line should be drawn in some particular place; there will be departments which will be hard to classify, so that a revision of the line may possibly be called for from time to time. The grounds on which the decision should be made in a particular case will appear as we go on. There are reasons why one classification would be better

¹ It might well be more in accordance with practice (and therefore more intelligible) if the trading departments were given the status of Corporations, which would be expected to do their accountancy on commercial lines. It has indeed sometimes been suggested that the trading functions of the Ministry of Food would be better transferred to a Food Trading Corporation. What is important for our purpose is that a transformation of this sort should be carried through at least on the accountancy level.

than another, but it is much more important that the line should be drawn firmly than that it should be drawn in some particular place. For the present it will be sufficient if we think of the 'spending departments' (defence services, social services, and so on) as administrative departments; and the Post Office, Ministry of Food, and so on as trading departments. It should, however, be understood that the line is to separate departmental accounts, not departments at the ministerial level. It would certainly happen in particular cases that a trading account had to be attached to an administrative department, as the Raw Materials Department is attached to the Board of Trade.¹ This should cause no difficulty, as the trading account is usually already a separate accounting entity. I shall take it that the Revenue Departments (Inland Revenue, Customs and Excise, &c.) would be administrative departments.

5. The principle would then be that, so far as the administrative departments were concerned, the traditional system should be maintained, and enforced in its full rigour. To the administrative departments, the Exchequer is a paymaster. They must therefore be obliged not to borrow or lend, and they must return unspent balances. The Exchequer's relations with the administrative departments would thus be entirely traditional; if these relations alone had to be considered, the Budget could be set out in an entirely conventional form, leading to a surplus or deficit of completely conventional character.

6. The trading departments should, however, be treated entirely differently. Their relation with the Exchequer should be entirely different. With respect to the administrative departments, the Exchequer is paymaster; but with respect to the trading departments, it is not a paymaster, *it is a bank*. The accounts of the Exchequer, in relation to the trading departments, ought to be modelled upon the accounts of a bank. The Treasury control, which is exercised upon the trading departments, ought to be modelled upon the control which a bank exercises upon its clients, not upon the control which the Treasury has exercised in the past upon the spending departments. This

¹ Sometimes an administrative department might be attached to a trading department, as in the case of the Ministry of Food, which has some administrative functions, though its main expenses are of a trading character.

is the only sort of control which can, without loss of efficiency, be exercised upon a trading concern. There is no reason why it should not be a very real control, and for its purposes entirely adequate.

7. It might very possibly be convenient to mark this double function of the Exchequer by dividing the Exchequer itself into two sections—an Administrative Section and a Banking Section. I am not at all sure that a formal division of this sort ought to be made in practice; but it will probably help us to see the banking functions of the Exchequer more clearly if we suppose, for purposes of exposition, that the division has been made. Except in so far as subsidies are paid to the trading departments (subsidies which would be treated, from the accounting point of view, in exactly the same way as subsidies to private industry), the trading departments would have their financial relations with the Banking Section of the Exchequer, just as the administrative departments would have their financial relations with the Administrative Section, jx. '

8. Unlike the Administrative Section, the Banking Section would need an account of commercial type, with a proper division between current and capital items. Its advances to the trading services would appear on capital account, and repayments of these advances would appear on capital account. On current account would appear the interest on these advances; interest on advances would indeed be the only contribution to revenue coming from the Banking Section. The Banking Section, as such, would make no contribution to current expenditure—unless it was desired to impute some sorts of office expenditure, but there would be little point in this.

9. Any direct loans made by the government to bodies outside its own organization, such as local loans, or loans to foreign governments, would also appear in the capital account of the Banking Section. New loans, and likewise repayments, would appear in the capital account; interest on such loans would appear in the current account of the Banking Section.

10. Thus the complete Exchequer account would consist of (i) the account of the Administrative Section, traditional in type, but capable of being considered, in its relation to the other accounts, as a current account; (2) the current account of the

Banking Section, containing nothing but interest on advances; (3) the capital account of the Banking Section, (i) and (2) could be combined to form the Revenue account of the Exchequer as a whole. The surplus on this combined revenue account we shall call the Exchequer surplus. The Exchequer surplus could evidently be calculated by methods which differ little from those which have traditionally been used for calculating the budget surplus; its assessment ought not to entail any practical difficulty. But, on the plan here being outlined, the Exchequer surplus is not the final budget surplus; before that can be attained, one further step, of great importance, has to be taken.

11. Before considering that further step, it will, however, be convenient to set out in tabular form an outline of the Exchequer accounts which we are proposing. This outline is shown in the table on the opposite page.

12. It is well to notice the exact meaning of the Exchequer surplus in the sense of this table. The Exchequer surplus would be the amount by which the net liabilities *of the Exchequer* would be reduced by the transactions of the year; and these net liabilities would be equal to the difference between the National Debt, on the one hand, and the assets of the Banking Section on the other, these assets including (i) obligations due from the trading departments; (2) debts owed to the Exchequer by bodies outside the central government.¹ This is all that can be shown in an Exchequer account; but the Exchequer surplus, in this sense, is definitely not the complete budget surplus in the sense needed for a modern budgetary policy. This complete budget surplus cannot be derived from the accounts of the Exchequer, not even when the capital account is considered as well as the revenue account. In order to arrive at the complete budget surplus, direct recourse must be had to the accounts of the trading departments. The complete budget surplus would be equal to the Exchequer surplus, plus what we may call the *surplus of profit* on the trading departments. This surplus of profit would have to be derived from the accounts of the trading departments, and combined with the Exchequer surplus in a separate operation.

¹ Changes in net liabilities due to revaluations of assets or liabilities would, however, be regarded as capital gains or losses and would be excluded.

TABLE I

Exchequer Accounts¹

i. *Revenue Account of Administrative Section*

Income from property (Crown lands, &c.)	A^{\wedge}	Administrative expenditure on goods and services	a_1
Tax revenue	C_1 (i)	Interest on National Debt	b_1
Transfers from other public authorities	C_1 (2)	Grants, subsidies, pensions	c_1
		Administrative surplus	$A_1 C_1 a_1 c_1$

2. *Revenue Account of Banking Section*

Interest on advances to trad- ing departments	B_1 (i)		
Interest on other loans	B_1 (2)	Surplus	B_1

3. *Combined Revenue Account*

Administrative surplus $A_1 C_1 - a_1 b_1 C_1$
 Surplus on Banking Section B_1 Exchequer surplus $A_1 B_1 C_1 - a_1 b_1 c_1$

4. *Capital Account (Capital Account of Banking Section)²*

Exchequer surplus $A_1 B_1 C_1 - a_1 b_1 C_1$			
Repayments by trading de- partments	E_1 (i)	Repayment of National Debt	e_1
Repayments of other loans	E_1 (2)	New advances to trading de- partments	f_1 (i)
New borrowing	F_1	Other new advances (to local authorities, foreign govts. &c.)	f_1 (2)
		Increase in cash balance	$A_1 B_1 C_1 E_1 F_1 - a_1 b_1 C_1 e_1 f_1$

¹ The symbols used for marking the items in the above table need not for the present be treated as anything more than tabs, by means of which an item can be identified as it is carried down. A further meaning will, however, be given to them in Chapter V (pp. 59-60).

² For certain purposes, as we shall see later, it may be convenient to introduce an item H_1 on to the capital account, to allow for capital gains and losses, due to revaluation of assets (or liabilities). It is only exceptionally that such an item would have to be introduced into the Exchequer account, but one such exceptional case is of importance in an end-of-war period such as the present (see below, pp. 36-9).

13. An adjustment of this kind should only be necessary for the case of the trading departments, save (possibly) in exceptional cases. For the administrative departments, no such additional item should need to be introduced, because of the convention of clearing the decks of the departments. So long as the departments do not borrow or lend outside, and return unspent balances, then, as we have seen, the Exchequer account mirrors the account of the whole government. In our proposed plan, this mirroring would remain so far as the administrative departments are concerned. But a similar clearing of decks is quite impossible in the case of the trading departments. They have a capital, with which they have been entrusted, and which is embodied at any particular time in the form of real assets or of trade credits. This capital cannot be liquidated at the end of each accounting period. The condition of the trading departments must therefore be taken into account, independently of the Exchequer account, if we are to get an account which represents the whole financial situation of the government. Once the trading departments become important, the consolidation of the government's accounts cannot be automatic, as it can be with the administrative departments. It has to be performed as a separate operation.

14. The case in which there is no *surplus of profit* in the trading departments (taken as a whole) is that in which their profits are just sufficient to pay the interest on advances which have been made to them by the Exchequer (and, as may happen in the case of the nationalized industries, the interest on any capital which they have issued in other ways); profits are just sufficient, but no more than sufficient, to cover these interest charges. In this case it would follow that any net advances made by the Exchequer to the trading departments during the year would correspond to an accumulation of net assets by the trading departments; either an accumulation of real assets (plant or inventories), or a balance of new lending or new investment (outside the central government) over loans repaid. In this case, then, the Exchequer surplus would be equal to a more fundamental magnitude. It would be equal to the amount by which net liabilities were being reduced, these net liabilities being now equal to the difference between the National Debt plus outside

liabilities of the trading departments, on the one hand, and government assets on the other hand—these assets being now represented, not by the paper assets of the Banking Section, but by the real assets of the trading departments plus debts due to the Exchequer or to the trading departments from bodies outside the central government. I would suggest that this is a more sensible meaning to give to the term *Budget Surplus*; but this budget surplus is only the same as the Exchequer surplus in the case where the surplus of profit in the trading departments is zero.

15. When there is a positive surplus of profit in the trading departments, the trading departments will have been accumulating assets in excess of the net advances made to them by the Exchequer; this excess is left out of the Exchequer surplus, but it would be brought in to the Budget surplus. Similarly, when there is a deficit on the trading departments, this deficit needs to be deducted from the Exchequer surplus in order to get the Budget surplus (or deficit).

16. Before going into any further detail, it will be desirable to set out the farther accounts, which are needed in order to take account of the results of the trading departments, in tabular form. The surplus of profit from each trading department would be calculated from a commercial profit and loss account for that trading department, of the type which has been produced for the Ministry of Food and other trading departments, in *Trading Accounts 1946-7*. The standard accounts of a trading department could then be summarized as shown on the following page (all items being calculated, as is proper in a commercial account, on an accruals basis).

17. A consolidated profit and loss account, and a consolidated capital account, for all trading departments taken together, could presumably be constructed in a substantially similar form. These consolidated accounts of the trading departments could then be combined with the Exchequer accounts to give a consolidated account for the whole of the central government. For the combined revenue account no more would be needed than to add the surplus of profit on the trading departments to the Exchequer surplus to get the Overall Budget surplus. The combined capital account would need to be presented in more

detail, with the new advances from the Exchequer and the repayments to the Exchequer disappearing on consolidation.

18. This is the formal skeleton of our proposed system. But it leaves open a number of special problems, some of them of considerable difficulty. I shall consider a few of these problems in the next chapter.

NOTE TO TABLES II AND III

When the trading departments are taken together, the new advances from the Exchequer to the trading departments, appearing in the combined account of the trading departments as $F_2 (i)$ will equal the new advances to the trading departments from the Exchequer appearing in the account of the Exchequer as $af_L (i)$. Similarly the repayments to the Exchequer appearing as $e_2 (i)$ will equal the repayments appearing as $E_1 (i)$. And the interest paid on Exchequer advances under $i_2 (i)$ will equal the interest received as $B_1 (i)$. Thus all these items cancel out in Table III.

TABLE II
Accounts of a Trading Department

i. <i>Trading Account</i>			
Current operating incomings	$X\%$	Current operating outgoings	x_2
		Depreciation	y_2
		Stock adjustment	z_2
		Trading profit	$X_2 - X_2 y_2 z_2$
2. <i>Profit and loss Account</i>			
Trading profit ($X_2 - x_2 y_2 z_2$)	A_2	Interest on Exchequer advances	b_2 (i)
Interest on trade credits and other advances made by department	B_2	Interest on other capital (including trade credits)	b_2 (2)
Subsidies received	C_2	Surplus of profit	$A_2 B_2 C_2 - b_2$
3. <i>Capital Account</i>			
Surplus of profit	$A_2 B_2 C_2$	Gross investment in real assets (real asset formation)	d_2
Depreciation (r_2)	(y_2)	Repayment of debts to Exchequer	e_2 (i)
Repayment of debts due from outside	E_2	Repayment of debts due outside	e_2 (2)
New Exchequer advances	F_2 (i)	New outside lending	f_2
New outside borrowing	F_2 (2)	Increase in cash	$A_2 B_2 C_2 D_2 E_2 F_2 H_2 -$
Capital gains (minus losses) from revaluation of assets	H_2		02^2/2

TABLE III
Consolidated Account of Central Government
(Overall Budget Account)

i. <i>Revenue Account</i>			
Exchequer surplus	$A_1 B_1 C_1 - a_1 b_1 c_1$	Overall surplus	$A_1 B_1 C_1 A_2 B_2 C_2 - f_1 f_0 c_1 b_2$
Surplus of profits on trading departments	$A_2 B_2 C_2 - b_2$		
2. <i>Capital Account</i>			
Overall surplus	$A_i B_i C_i A_2 B_2 C_2 - a_i^2 f_i^2$	Gross investment in real assets	$r f_2$
Depreciation	D_2	Repayment of debts due to outside	f_1^2 (2)
Repayments of debts due from outside	E_1 (2) E_2	New outside lending	f_1 (2) A
Borrowing from outside	$F_1 F_2$ (2)	Increase in cash	$A^2 C^2 F^2 B^2 C^2 D_2 E^2 F^2 H^2 -$
Capital gains (minus losses)	H^*		01^2 C_1^2 - ?/1 M_2^2 / 2

III

SOME SPECIAL PROBLEMS

1. *The line of demarcation.* It will be convenient to begin our discussion of these special problems by reconsidering the demarcation between administrative and trading departments. The essential feature of the distinction, according to our plan, lies in the relation of the Exchequer to the department in question. There are some departments, such, for instance, as the Home Office or the Foreign Office, which the 'administrative' arrangement fits perfectly; they could only be treated as trading departments by a fantastic amount of accounting make-believe. On the other hand, there are departments like the Post Office, which have for some time been tending towards a position which approximates to that of our trading departments. These are clear cases, but there are some cases which are not at all clear.

2. *The New Trading Services.* There is, in the first place, a group of departments which have become of major importance in the period of war and post-war socialism—the Ministry of Food, the Raw Materials Department of the Board of Trade, and the Ministry of Supply. These are, in the natural sense of the word, unquestionably trading departments; and from one point of view they have been treated as such, for they have been allowed to do their accounting on a commercial basis. But at the same time they have not emancipated themselves from the other sort of accounting, the kind which (we are here maintaining) is only appropriate for administrative departments. They have, in fact, had two sets of accounts side by side, the one on the one basis, the other on the other.¹ This cumbersome arrangement has been defended on the ground that the trading activities of these departments are a temporary phenomenon; they are due, sooner or later, to abandon their trading functions. However that may be, it can hardly be denied that the arrangement now existing is a bad one. Once the status of trading department,

¹ The *Trading Accounts* are published (see above, p. n); but it is the 'Administrative' accounts of these departments which are reflected in the accounts of the Exchequer.

as we have outlined it, was established and recognized, these departments would fit quite naturally into that position. I shall henceforward take it for granted that this group of departments would be trading departments.

3. *Other Public Undertakings.* Secondly, there is a long list of public undertakings, ranging from the nationalized industries at one end to such bodies as the British Museum at the other, the ultimate ownership of which rests with the government, though they are not regarded as government departments for budgetary purposes. Should these undertakings be regarded as trading departments? My own view is that it is desirable that they should be. Of course no one would desire to treat them as administrative departments; the practical issue is whether they should be treated as trading departments or should be regarded as falling for budgetary purposes altogether outside the government sector. Now one cannot help suspecting that it is because, up to the present, all government departments have tended to be treated as administrative departments that these undertakings have tended to escape from budgetary control. If a form of control, more suited to their needs, were available, there would be much to be said for bringing them in. This, however, is a large issue, to which we shall be returning in other connexions.¹ The general plan, outlined in the preceding chapter, could work, whatever decision were taken on this matter. Some, or all, or none, of these undertakings could be treated as trading departments.

4. *National Insurance.* Thirdly, I come to a very important, but very awkward, case—that of the National Insurance Funds. On a strict interpretation of our principles, these funds ought either to be brought inside the Exchequer budget, or they ought to be treated as trading departments. But in their case, neither of these treatments seems appropriate. There are strong political reasons for maintaining the apparent independence of the National Insurance system, which would appear to be lost if it were brought inside the Exchequer budget. On the other hand, there can really be no doubt that commercial accounting is irrelevant to Social Insurance—much more irrelevant than it is in other border-line cases which we shall be con-

¹ See below, pp. 45, 79-80.

sidering in a moment. The insurance element in National Insurance is, and always has been, more than a little bogus; economically considered, National Insurance is a social service, financed to a large extent, but not wholly, by two special taxes, the employer's and the worker's contribution. From this point of view, the traditional form of accounting adopted for these funds (modelled upon the traditional Exchequer accounting) seems wholly appropriate. It would be folly to disturb it. But if it is left undisturbed, then the surplus on the insurance funds (calculated as it is calculated at present) must be added in (with the Exchequer surplus and the surplus of profit in the trading departments) as a third constituent of the Overall Budget surplus in Table III. Interest payments or receipts by the insurance funds will of course then cancel out against interest receipts or payments by the Exchequer. And the advances or repayments between the insurance funds and the Exchequer must be cancelled out when forming the Consolidated Capital Account in Table III. This seems to be the best (as it is certainly the simplest) way of dealing with the insurance funds. We shall assume that this treatment has been adopted when we come to consider the place of the budget accounts in the accounts of the whole national economy, as we shall be doing in Chapters V and VI.

5. I have left the most intricate of these demarcation problems to the last. There are some government departments which are not trading services, if the criterion of a trading service is that it sells services or goods to the public; and yet they are such that commercial accounting has a distinct relevance to their problems. This is because they have a capital embodied in physical assets, which they need to maintain, just as a business needs to maintain its capital intact. There is therefore a case for treating these departments as trading departments, although the trading account of such a department would be bound to look very different from the trading account of a company or private firm. These cases are the most crucial among the border-line cases. It is not essential to our plan that these departments should be treated as trading departments; and no doubt that is just as well, because the idea of treating them as trading departments will be found by many people hard to

swallow. Nevertheless, if they are treated as administrative departments, there will be some rather unfortunate consequences.

6. *Roads.* Take, for instance, the case of expenditure on roads. Economically considered, roads are a real capital asset; road maintenance is a part of the maintenance of the social capital, and construction of new roads is a part of real investment, or real asset formation. The Roads Department of the Ministry of Transport is like a trading department, in that it is entrusted with a capital which it has to maintain; but it is unlike a trading department, in that it does not earn money by the use of that capital. An abortive attempt was made in the past to treat the Roads Department more or less as a trading department, by the institution of the Road Fund; but at present the Road Fund retains no more than a nominal existence, and roads are effectively treated as being administered by an administrative department.

7. It would not be necessary, on our plan, that the Roads Department should remain an administrative department; nor would it be necessary that it should cease to be an administrative department. The plan could be worked on either decision. But each decision would have definite consequences. If the Roads Department remained an administrative department, then the real capital embodied in the roads would not be treated as a part of the assets of the central government, and road development would not be treated as an addition to those assets. Road expenditure, of whatever sort, would be treated as current expenditure; thus any expansion in road expenditure (of whatever sort) would reduce the budget surplus, or increase the budget deficit. Administratively, this decision would have many conveniences, but its consequences would need to be faced. If it was desired to avoid those consequences, then (on our plan) that could only be done by classifying the Roads Department as a trading department. It would undoubtedly be a peculiar kind of trading department, but the decision to make it a trading department would not necessarily imply more than the decision to apply to it the methods of commercial accounting, and the application of commercial accounting to this case is not in principle impossible.

8. The Roads Department, considered as a trading department, would have no operating receipts; the only item on the active side of its account would be its subsidies from the Exchequer. Similarly the current operating outgoings would be negligible, and the stock adjustment negligible; the main item on the passive side would be depreciation. In order that the surplus of profit on the Roads Department should be zero, the subsidy would have to be sufficient just to cover the depreciation on the roads, plus interest on Exchequer advances. The 'profit-and-loss account' so drawn up would be an exceedingly sketchy affair, but it would not therefore be useless. For it would serve to indicate that what the subsidy to the roads would have to cover would not be road expenditure, but depreciation plus interest. (In this case the best available measure of depreciation would be the amount of maintenance *due* on the roads during the year in question to maintain them in condition; and this would not be the same as the maintenance actually carried out.)

9. In conditions in which the roads were being fully maintained, and road improvements being made, the capital account of the Roads Department would show new Exchequer advances on the one side, and the cost of improvements and new constructions (as fixed asset formation less depreciation, or what economists would call net investment) on the other. These improvements would thus appear, when the government accounts were consolidated, as an addition to government assets. If the roads were being undermaintained, fixed asset formation (less depreciation) would be negative; the Exchequer should, however, still pay a subsidy to cover depreciation.¹ The difference could either be used to repay Exchequer advances, or (if there were no advances to repay) would mount up as a departmental deposit in the Exchequer 'bank'. In either case, the department would be accumulating a depreciation fund, which should be kept at a level sufficient to restore the roads, when the time came, to a condition comparable with their condition when full maintenance ceased.

10. The accounts of the Roads Department, considered as a trading department, could thus be formally outlined as follows.

¹ If it did not do so, the Roads Department would make a loss, which would have to be taken into account in the Overall Budget.

In this rudimentary account I suppress the trading account, which (in strictness) would merely show the maintenance due as an expense with no commercial incomings to balance it, so that the maintenance due would appear as a trading loss.'

TABLE IV

Accounts of Roads Department, considered as a Trading Department

1. <i>Revenue Account</i>			
Subsidy or grant	. . . C	Maintenance due	. . . A
		Interest on Exchequer advances	. . . h
		Surplus of profit	. . . C—Ab
2. <i>Capital Account</i>			
Surplus of profit	. . . C—Ab	Gross investment in real assets	. . . d
Depreciation (= A)	. . . D	Repayment of Exchequer advances	. . . e
New Exchequer advances	. . . F	Increase in cash	. . . CDF—Abde

It is, of course, to be hoped that careful control would keep the balancing items (*surplus of profit* and *increase in cash*) fairly negligible.

11. Whether it is, or is not, desirable to do the accounts of roads in this way is a very arguable matter. It is not my business here to pronounce on the issue one way or the other. But the special case of roads has been worth analysing at some length because it serves to illustrate the problem which is bound to come up in many marginal cases. Some of these 'semi-trading' departments will be less completely dependent on subsidies from the Exchequer than the roads are; but even if they have some commercial revenue, it has still to be recognized that there is bound to be something artificial about any trading accounts one can give them. Nevertheless, it must be emphasized that the construction of an account of commercial type, however artificial it may seem, is the only way of allowing for real asset formation, or real investment, in an accounting structure. If it is decided that the making of a commercial account is too artificial, then there is nothing for it but to treat the department as an administrative department; and that

ultimately means that one cannot take credit in the Budget accounts for any accumulation of real assets which occurs in the course of the operations of the department in question.

12. *Depreciation and Maintenance.* We have seen that an essential feature of a 'trading department' account is the assessment of a figure for depreciation on the fixed assets in the possession of the department. In many cases, the only way of assessing such depreciation will be to follow the business practice of taking a conventional percentage of the original construction cost. But there are some cases (such as the case of roads which we have considered) in which an assessment of maintenance due may be actually more meaningful.¹ In any case, the applicability of the 'trading department' method to a department with fixed assets depends upon the possibility of arriving at a figure for depreciation which has at least some sense. If such a figure seems unattainable, then it looks as if it would be wiser to stick to the conventional practice, and to treat the department as an administrative department.

13. *The Office of Works.* A case which at first sight looks parallel to the case of Roads is that of the Office of Works. Like the Roads Department, the Office of Works has real capital assets to administer; like the Roads Department, it does not charge for their use. The government offices and public buildings for which it is responsible are justly regarded by economists as part of the social capital; improvements and new constructions of public buildings are as properly regarded as a part of real investment as improvements or constructions of any other buildings. Thus the Office of Works could be given a commercial account, and there would be advantages to be got from giving it an account on that basis. But its accounts should not be in exactly the same form as those which we have outlined for the Roads Department. Its incomings should not take the form of a subsidy, like the incomings of the Roads Department. For the Office of Works is one of those departments which largely operate by performing services for other departments;

¹ The reason why the maintenance method is the right one in the case of roads is that a road can be kept almost continuously 'as good as new' by adequate maintenance. This is not possible in most other cases, as, for instance, in the case of buildings. An estimate of depreciation, over and above maintenance due, is then required.

its apparent failure to earn a revenue of its own is merely one aspect of the general problem of interdepartmental transactions, to which we must now turn.

14. *Interdepartmental transactions.* So long as all departments of government are treated as administrative departments, it is not necessary to be very systematic in the allocation of expenditure on particular services to the departments responsible for those services. One department performs services for another, and no payment is made by the one department to the other for the services. This arrangement causes untold trouble when an attempt is made to assess the total cost to the government of some particular service; for the expenditure entailed by that service will not all of it be found in the accounts of the department primarily responsible. Various bits will be hidden away in the accounts of other departments. It would obviously be much better, for the sake of efficient administration, if more care were taken to see that ancillary expenditure was imputed to the department mainly responsible for the service;¹ but the defects of the present system with regard to this matter (I am in agreement with the critics that they are very serious defects) do not affect our present problem, so far as transactions between administrative departments are concerned.

15. Once a department is classified as a trading department, it does, however, become essential that it should be kept clear of this mix-up. The accounts of the trading departments are to be modelled on business accounts; if they are to make sense as business accounts, they should include (so far as possible) a proper commercial value for the services provided. The trading departments must be paid, both for the services which they render to the administrative departments, and for the services which they render to each other. This principle has been recognized in practice, in the commercial accounts which have been prepared for the Ministry of Food and the other new trading services; these departments are charged, in their trading accounts (but only in their trading accounts)² for the services

¹ Some information about interdepartmental transactions used to be tabulated, before 1939, in *Gross and Net Costs of Public Departments* (e.g. H. of C. Paper 42 of 1938). This information was therefore capable of being extracted, but it was not available in time for budgetary discussion.

² See above, p. 24.

which are performed for them by other departments, and are credited for the services which they perform for other departments. Thus the principle is already established and only needs to have its consequences followed through systematically.

16. On this principle, once the Office of Works was made a trading department, it would have incomings in the form of rents paid to it by other departments (and which would, of course, be reckoned by those other departments as part of their expenditure). But it should not be expected that these rents (and any other rents which might be paid to it by other persons or bodies) would cover the whole of its costs. It would still need a subsidy to cover such things as its housing activity (so far as that is intended to be subsidized) and its care of ancient monuments. But in all this there would be nothing very peculiar. A commercial account of this type could also be provided for other departments which are in a broadly similar position, such as the Stationery Office.

17. This concludes what I have to say on problems of demarcation; those which will occupy us for the remainder of this chapter are of a different type. Most of them are issues which bulk very large in recent budgets, but which may be expected to become of less importance when (and if) times become more settled. As a preliminary, we may make a fuller study of one of the questions already raised in Chapter I—that of the Unspent Balances.

18. *Unspent Balances.* We saw in Chapter I how this problem arises. On the traditional system, if it worked as (I believe) it was intended to work, the departments should, at least notionally, repay all surplus funds to the Exchequer at the end of every financial year, and should have those funds reissued to them in a transaction which would reckon as the first transaction of the new year. If this could be done, the net issues from the Exchequer during each year (total issues minus repayments) would exactly equal the expenditure of the departments. But in fact it is not done; the departments are allowed to carry over working balances, and the amounts of these balances may not be known at the time the accounts of the year are presented. A watch is kept to see that the balances do not remain for long at an abnormal level; when they are found to have reached an

abnormal level, the surplus has to be repaid to the Exchequer. But this is something much looser than the strict traditional system. It has sacrificed many (though certainly not all) of the advantages of the traditional system, and the accounts which emerge from it may be very seriously misleading.

19. In order to see what may happen, let us take an arithmetical example. Suppose that the normal rate of expenditure by a particular department is 100 (£ millions) and that it is normally allowed to keep a working balance of 10. So long as it remains in this normal position, all goes smoothly. An issue of 100 will be made by the Exchequer, 100 will be spent by the department, which finishes the year with a balance of 10, the same as it had at the beginning. The mirroring of the departmental expenditure in the books of the Exchequer is perfect. Now, after a first year in which things have proceeded in this normal manner, comes a second year in which the department's expenditure falls to 95. Suppose that the Treasury, which has budgeted for 100, issues 100 as usual. Then at the end of this second year the departmental balance will have risen to 15, and during the second year the issue from the Exchequer will have exceeded the departmental expenditure by 5. There follows a third year in which the department continues to spend 95; by this time the Treasury has realized that it is unnecessary to budget for the higher rate of expenditure, and accordingly the issue is cut down to 95. With an issue of 95 and expenditure of 95 the departmental balance will remain unchanged—at 15. But, we may suppose, the department will not be allowed to keep its balance at the abnormal level of 15; it will be made to refund 5 to the Exchequer. Accordingly, in this third year, while expenditure remains at 95, the *net* issue from the Exchequer is only 90. The balance has then been restored to a normal level; if expenditure remains at 95, the issue from the Exchequer can remain at 95 without further disturbance.

20. Summing this up, if there is a drop in the expenditure of a department, the net issue from the Exchequer will tend to be greater than the departmental expenditure in the year when the drop takes place, and to 'compensate' by being less than the departmental expenditure in the year (or years) immediately

following. In our illustration the departmental expenditures in the four successive years are

Joo' 95> 95, 95

while the net issues from the Exchequer are

100, 100, 90, 95.

The total, over the four years, is the same; but the time-distribution is seriously different. In particular, there is an apparent easing of the Exchequer position in the third year which is doomed to be temporary, and which represents no true easing in the financial position of the government as a whole.

21. In principle the same kind of thing can happen when expenditure is increasing; but it is then less likely to be important (save in respect of one further complication to which we shall come in a moment). For a department will surely complain soon enough if its balance is falling below a normal level; it is on the other side that there is a danger of delay. And it is only at a time when expenditure is falling with exceptional rapidity (as happens at the end of a war) that the discrepancy becomes so large as to be a significant item in the budget. At other times it is possible for the Treasury (which is well aware of the difficulty) to meet it by various shifts and adjustments. It should further be noticed that the difficulty is one which, on our plan, would be peculiar to administrative departments; it could not arise in the trading departments. Thus if the circle of the administrative departments was restricted, the scale on which a discrepancy of this sort could occur would be reduced. It would be easier for the Treasury to keep track of what was happening and to keep the fluctuations in departmental balances more nearly within bounds.

22. Nevertheless, the difficulty would sometimes arise; and we have to face the question what should be done about it. It has been suggested to me that the case would be met if there were a definite rule that repayments from the departments, *which did not originate in issues made during the current year*, should be paid into the Exchequer capital account. This device has the merit of avoiding the unwarranted apparent dip in expenditure (as in the third year of our example). The issue

from the Exchequer, on revenue account, would in that year be 95, and would thus already square with the new rate of expenditure. But in spite of this advantage, I cannot find that the proposed device is satisfactory. It is difficult to find a logical place for the receipt on the capital account; but even if this difficulty could be overcome, there is another which is much more serious.

23. We have so far been assuming that the *normal* level of the departmental balance, as agreed on between the department and the Treasury, remains unchanged throughout the whole story. But why should it? If the activities of a department expand, it will need a larger balance; if they contract, its normal balance should decline. In particular, when a new department, or branch of a department, is started, its working balance must rise from nothing to a substantial figure; thus in the first year (or even years) of its life, issues from the Exchequer to a new department must be in excess of its expenditure. Similarly, when a service is closed down, its working balance must fall to nothing. Here again the matter can be met (and I understand that it normally is met) by special adjustments, provided that the changes are not too great. It is when a number of big movements of this sort take place at once that the difficulty comes out into the open.

24. When we take these things into account, it becomes apparent that the 'Vote of Credit balances', which have drawn so much attention in the post-war budgets, are only a particular indication of a much larger question. What we need is not merely a device for presenting certain special receipts in their appropriate place in the Exchequer budget; the whole question of changes in departmental balances needs to receive, in some place, explicit attention. If it did receive that attention, the 'Vote of Credit balances' would look after themselves. This, I think, is the line on which we must work if we are to find a fully adequate solution.

25. What I would thus propose should be done is the following. Let the receipts from unspent balances continue to appear in the revenue account of the Exchequer, as they have done up to the present. (This will help to keep the capital account, in the way it should be kept, as an intelligible account of the

Exchequer 'bank'.) But let it be laid down that one of the questions which must be answered in the budget statement, and should be discussed by the Chancellor in his budget speech, is to relate to the change in departmental balances. It is the very crux of the difficulty that the change in balances, which has occurred during the financial year, cannot be known precisely at the time when the budget is presented; but if it was one of the matters on which information had to be provided in the budget, something which was useful could undoubtedly be said. Especially in a case when a large item for repayment of balances appeared in the Exchequer statement, it could be stated whether or not it was to be inferred that there had been a net fall in departmental balances approximately equal to that sum. And it is hard to believe that it would be impossible to do much better than this. A provisional estimate of the change in balances ought to be available, not a final figure, but one which gave the right impression.¹ Being no more than an estimate, this figure should not be included in the Exchequer account proper. But it should appear as an addendum to that account. This addendum should state the estimated change in balances and the *adjusted surplus* as it would be when allowance was made for this change in balances. The *adjusted surplus* could be defined as an estimate of what the Exchequer surplus would be if the ideal system of returning all balances within the year had been enforced throughout the administrative departments. It would be this adjusted surplus which would be relevant to the Overall Budget. Of course one would hope that in normal times the adjustment would be inconsiderable. But if it does become considerable, this seems to be the way to treat it.²

26. *Surplus Stores.* Another special problem of end-of-war financing, which raises equal, though not so far-reaching, difficulties, is that of surplus stores. The proceeds from the sale of war stores amounted to nearly £200 millions in the 1947-8 Budget. Let us consider how these should have been fitted into the accounts.

¹ The actual change in balances during the year should of course be discovered sooner or later and should be placed on record as a test of the reliability of the estimation.

² The form in which the account would appear, when allowance had been made for this adjustment, is illustrated in Table 3 of the Tabular Appendix.

27. There can be no doubt that Defence Departments should, in principle, be treated as administrative departments. Although modern war involves so vast an accumulation of war material, few people would desire to see that material treated, for accounting purposes, as an accumulation of real assets. From an economic point of view, it seems reasonable to regard resources as being spent at the moment when they are embodied in war material, not at the moment when that material is physically consumed or destroyed. This is in fact what is done. But it raises the difficulty that at the end of a war some of the resources which have been absorbed by the Defence Departments may be recoverable. They have, in effect, been written off; but they can now be recovered and transformed into real assets. What is the best way of expressing this transformation in terms of the accounting structure?

28. In order to answer this question, I shall first of all explain what seems to me to be the ideal solution; and then, since this ideal solution is not very practicable, I shall explain what seems to be the practicable alternative. It is necessary to adopt this procedure, because the practicable method is best regarded as an approximation to the ideal solution; it is much less defensible when taken in its own right.

29. The ideal solution would be to treat the bodies disposing of surplus stores as trading departments, brought into existence for the purpose of the disposal. The capital of such a Disposals Department would be advanced to it by the Exchequer, in the form of the physical stores, valued in what would inevitably be a very conventional manner. Or perhaps it would be more accurate to think of the Exchequer advancing (say) £200 millions to the Disposals Department and the Disposals Department using that £200 millions to purchase the stores from the Defence Departments. The Defence Departments receive this £200 millions which they then transfer to the Exchequer in very much the same way as the departments return to the Exchequer the unspent balances previously discussed.

30. From the point of view of the Exchequer, the £200 millions would be a receipt on revenue account, coming under $C(z)_y$, exactly like the receipt of the unspent balances. But once again it is a receipt from other departments, and administrative

departments at that, which should disappear on consolidation; it therefore calls for a further adjustment in the adjusted account. But the nature of the adjustment would be somewhat different. In the case of the unspent balances, the Exchequer surplus is reduced on revision, because the loss of cash to the departments has to be allowed for as soon as we treat the Exchequer account as something more than the account of a particular branch of the government. In the case of the surplus stores, on the other hand, there is no similar loss of cash. What has happened is that the Defence Departments have experienced a capital gain, due to revaluation of assets, and it is this capital gain which needs to be shown in the adjusted account. The adjusted revenue account of the Exchequer will therefore show a surplus diminished by the £200 millions; but the reduction of the Exchequer surplus by £200 millions will be matched by a capital gain of £200 millions which would have to be shown on the capital account.

31. If, in the course of the operations of the Disposals Department, it made a surplus of profit, in the sense of selling the stores for more than the value at which they had been transferred to it (plus interest), then this surplus of profit would be included, according to our principles, in the Overall Budget surplus but not in the Exchequer surplus. If the Disposals Department made a loss, that loss also would be allowed for in the Overall Budget surplus. When the time came for the Disposals Department to be wound up, its capital would be returned to the Exchequer (as a repayment E^i), any surplus or deficit finding its way into the Overall Budget for the year as a surplus or deficit of profit from trading departments.

32. This, I believe, is the ideal solution; but it must be frankly admitted that this ideal solution could not prove satisfactory in practice. It will be noticed that the practical result of the procedure depends entirely upon the value set upon the stores when they are transferred to the Disposals Department; and that value has been admitted to be both conventional and arbitrary. It would be formally consistent with the above procedure to transfer the stores to the Disposals Department at a value of zero; but in that case the whole value of the stores, as they were sold, would appear as a contribution to the budget

surplus, though, of course, not to the Exchequer surplus. On the other hand, if by some chance (or miracle) the value set had been exactly *right*¹ so that the Disposals Department made neither surplus nor deficit, then the disposals would make no contribution to the budget surplus; the whole result of the disposal on the finances of the government would appear as a capital gain in the capital account of the Exchequer.

33. There can be no doubt that this latter result makes much better sense, but it would not readily be reached by normal accounting practice. It could, however, be reached in terms of our structure if a special rule were made that all profits from surplus stores were always to be reckoned as capital gains, and were to appear directly as such in the capital account of the Exchequer. Since, in practice, the disposal of war stores is bound to be a gradual business, the result of this rule would be that the capital gains would be spread over a period of years, instead of appearing at the moment when the decision to dispose of the stores was taken, as would in principle be more desirable. But while it is a matter of great importance that items belonging to the revenue account should appear in the right year (for otherwise the whole concept of a surplus or deficit becomes completely arbitrary), it is not a matter of great importance that capital gains and losses should be registered in the capital account at the right time. The relatively simple rule of always reckoning receipts from the sale of surplus stores as capital gains—which rule could be easily introduced into the ordinary Exchequer budget, and need not wait upon any 'adjustment'—does therefore in practice sufficiently meet the case.¹

34. *Compensation Payments.* An item which is becoming of great financial importance at the present moment, so that it deserves a little explicit consideration, even at the end of this long and various chapter, is that of compensation payments, usually arising in connexion with nationalization. Our principles can be applied to this case without special difficulty, but the consequences of applying them had better be set out.

35. In the case of the nationalized industries, the compensation to shareholders has usually been regarded as a direct charge

¹ The rearrangement of the 1947-8 account, as shown in Table 3 of the Tabular Appendix, has been carried through on the basis of this *special rule*.

on the industry, and has been kept away from any relation with the budget. On our plan, this arrangement might have to be reconsidered. In no case would the compensation to shareholders appear in the Exchequer accounts; and if it was decided that a particular nationalized industry fell altogether outside the government sector, then its accounts would have nothing to do with our problem. But once a nationalized industry was to be classified as a trading department (and there would be distinct advantages to be got from that arrangement,¹ especially in those cases when the industry was to be dependent on the Treasury for funds), its transactions would have to be taken into account in the Overall Budget. Thus, for instance, if the Coal Board were to be reckoned as a trading department, though its acquisition of the coal-mines would not have figured in the accounts of the Exchequer, it would have figured in the overall capital account. Here, in the year of nationalization, the compensation payments would figure as a new government liability, and the physical assets acquired from the coal-owners would appear as a corresponding new asset.

35. More difficult cases appear when we turn to compensations for the loss of specific rights, such as land development rights (taken over under the Town and Country Planning Act) or the right of doctors to sell practices. In some of these cases it may be more difficult to look at the transaction as the acquisition of an asset by the government, even when the notion of an asset is extended to cover economic but non-commercial assets, as we have illustrated above in the case of roads. If a case is to be made out for the treatment of the acquisition on trading department lines, it must be shown that it is possible to construct a trading department account for it which is not of too artificial a character. Otherwise, it will be wiser to keep the service concerned within the scope of the administrative departments, and therefore to regard the expenditure on compensation as part of the current expenditure of the year in which it occurs. I should myself judge that a trading department account could in principle be constructed for the Central Land Board, but that compensation to doctors could hardly with any plausibility be treated in this way.

¹ See below, p. 45.

36. It has, however, to be recognized that the treatment of any compensation payment as an item of current expenditure, though it may be wise to treat it in this way as a matter of budgeting, raises awkward problems when we come to consider the place of the government accounts in the accounts of National Income and Expenditure of the whole economy. For though the government may treat the item as a current expense, it will not be treated as a current receipt in the accounts of those who receive it; they will surely regard it as a capital item. Similar difficulties arise in the case of certain taxes. Death duties have ordinarily been regarded by the government as a source of current revenue; but the sum paid out in death duties is not regarded as being paid out of current income either by the testator or by the legatee. This is, however, at least in my opinion, a matter for social accounting—for the accounts of the National Income and Expenditure; it would only make for confusion if we tried to adapt our definition of the budget surplus (as some recent commentators have done) in order to allow for it. Very careful attention will have to be paid to such *capital transfers* when we come to consider the relation between the budget and the social accounts.

IV

BUDGETARY PROCEDURE AND TREASURY CONTROL

1. SUPPOSING that a plan, such as has been outlined in the foregoing chapters, were to be adopted, how would it work? Up to the present we have been looking upon it as a rearrangement of the public accounts, designed to give a clear and consistent picture of the government's finances during a particular year, as it could be shown at or after the end of that year. But in fact the arrangement of the public accounts has more functions than this, and some of the other functions are quite as important. How does our proposal look in the light of these other functions?

2. As far as the administrative departments and the corresponding 'administrative section' of the Exchequer are concerned, we are in fact proposing no alteration at all in the present system. There would thus be no reason whatever why any aspect of the present system should be affected. The administrative departments would draw up their estimates in the usual way, and they would be voted on by Parliament in the usual way. All the alterations would be concentrated on the trading departments and on their relations with the Exchequer—and these alterations could be made more or less revolutionary according as the list of departments to be accorded the status of trading departments was long or short.

3. Let us first of all consider the working of the system in that 'normal' state of affairs in which each of the trading departments was running on an even keel, so that it was covering its costs, including interest due to the Exchequer, but was otherwise making neither profit nor loss. (This assumes, of course, that non-paying departments such as roads have not been reckoned as trading departments.) In such a case the Chancellor would be able to report his Exchequer surplus or deficit (from which capital items would have been excluded in terms of our conventions); and then, since no adjustment needed to be made for the results of the trading departments, he would be

able to identify the Exchequer surplus or deficit with an Overall Budget surplus or deficit. And if he felt that he could reasonably anticipate a continuance of the balance in the trading departments, he would still need to take no direct account of the trading departments when he turned to the budget for the coming year. He would take the estimated expenditure of the administrative departments and the estimated revenue from taxation and other sources (including interest due from the trading departments) and from these derive his anticipated Exchequer surplus or deficit (which he could again equate with an anticipated Overall Budget surplus or deficit) and budget accordingly. I should emphasize that I am not in the least assuming that he should, even in this case, necessarily plan to balance the budget; that depends, as is now generally recognized, upon wider issues of economic policy, on which I shall have something to say in their place.

4. Let us next suppose that there has been, during the past year, a deficit on some of the trading departments. It is, perhaps, not very likely that that deficit can be accurately assessed at the time when the budget comes to be presented; but surely it ought to be possible to make a reasonably good estimate of the deficit, sufficiently good for the results of the trading departments to be given a place in the general financial picture. More accurate accounts could be brought out in due time. It ought, I think, to be regarded as a responsibility of a public trading service, just because it is a public body, to keep the government specially well informed, and promptly informed, of its financial position. I shall accordingly assume that such an estimate would be available.

5. In this case, then, the Chancellor would have to report an Exchequer surplus (or deficit), and that the surplus was partly or wholly offset, or the deficit increased, by a deficit on the trading departments. He would then have to consider whether to take account of the trading deficit in his forward budgeting. If he judged that the deficit was unlikely to recur in the coming year, there would then be no need to take account of it in his estimates; but if it was judged that it was likely to recur, it would be wise to budget for its recurrence.

6. This could be done in one or other of two ways. If it was

decided that, as a matter of public policy, a particular trading department was not to plan to cover its costs during the coming year, then the amount by which it was expected to fall short could be allotted to it as a subsidy. This subsidy would be treated, in the national accounts, just like a subsidy to private business; it would thus appear as a direct charge on the revenue account of the Exchequer. It would, of course, leave behind it in future years no charge on the accounts of the trading department which was subsidized.

7. It might, on the other hand, be desired to allow the trading department in question to make a loss which was not to be forgiven it outright in this way. (Some of the terms of the Nationalization Acts suggest that this is intended to be a normal procedure with the nationalized industries.)¹ In this case the Chancellor would budget for a loss which was not to be covered by subsidy but by loan from the Exchequer. The Exchequer would advance a loan to cover the loss with the intention that the loan should be repaid out of profits when times improved. There is nothing in our principles which offers any reason why this method should not be adopted on occasion; presumably the point of arranging things in this way would be to get a lever for insisting that profits were earned when conditions were favourable and were not swallowed up in political pressure to raise wages or lower prices.

8. It is, however, a matter of the greatest importance to notice that the fact that the loss is to be covered by a loan from the Exchequer instead of a subsidy merely transfers it from the revenue account to the capital account *of the Exchequer*. As far as the Exchequer is concerned, the out-payment is matched by the acquisition of a paper asset, in the form of a debt to the Exchequer from (say) the Coal Board. But as soon as we consolidate the accounts of the government as a whole, *in the sense in which the Coal Board is a part of the government*, it becomes apparent that this debt is a purely internal transaction. The loss has to be treated as an expense of the government as a whole, whether it is treated as a loss (to be covered by an Ex-

¹ Thus the Coal Board is bidden to cover its costs 'on an average of good and bad years'. The case which we are now considering is that of a year which is *expected* to be 'bad'.

chequer advance) or is covered by a subsidy. In either case it appears as an expense in the Overall Budget.

9. In exactly the same way, when it was desired that a trading department should more than cover its costs—as a contribution, let us say, to an anti-inflationary policy—the Chancellor would be able to choose whether (1) to impose a tax upon the earnings of that department, which would appear as a revenue item in the accounts of the Exchequer, or (2) to budget for a surplus of profit, which should be employed in paying off Exchequer advances, or perhaps in making a departmental deposit in the Exchequer. Here again the surplus of profit, like the tax, would appear as a revenue item in the Overall Budget.

10. It is largely in order to extend the scope for this sort of budgeting that there is a case (as previously mentioned)¹ for bringing the nationalized industries within the circle of the trading departments. But I am well aware that the idea will not be found easy to swallow. It has so often been emphasized that socialized undertakings must be kept free of Treasury control if they are to achieve business efficiency; the form of the Public Board or Public Corporation has been so deliberately designed for them with this purpose; consequently our claim that they should be brought back within the budget may seem altogether retrogressive. Yet, when one thinks it through, it becomes abundantly evident that we shall get no sound finance, and no sound anti-cyclical finance, unless this is done. What one wants, for the general purposes of sound finance, is that the entire financial responsibilities of the government should, at a certain stage, be brought under comprehensive review; and the nationalized industries are beyond any question included in these responsibilities. What one wants, for the purposes of anti-cyclical finance, is that as much as possible of the resources at the disposal of the government should be available for fighting unemployment and for controlling inflation. If the nationalized industries are to be excluded from the resources so disposable, the opportunities for anti-cyclical policy will be severely curtailed. They will be needed to play their part—and it has evidently been intended that they should play their part—in a

¹ See above, p. 25.

general policy of stabilization. It would not be possible to construct a 'full employment' budget without paying careful attention to the results and plans of the nationalized industries; much the simplest way of paying this attention is to bring the accounts of these industries inside an Overall Budget of the kind we are defining.

11. The full reason of principle why it is necessary to bring the nationalized industries inside the Overall Budget will appear when we turn to consider budgetary policy.¹ But at the moment it is more pertinent to emphasize that the inclusion means no more than their classification as trading departments in the sense intended in our plan; and this need not infringe their autonomy, nor infringe the principle of treating them as business concerns. If indeed it were implied by their inclusion in the Overall Budget that they should be subjected to Treasury control of the traditional type, that would undoubtedly be impossible. But it is implied in our plan that the traditional type of Treasury control should be confined to the administrative departments. The trading departments would, it is true, be subject to some control, but it would be a different sort of control, a control of a type which can be, and is, exercised over independent businesses. The control which would be exercised over the trading departments would be a *banking* control.

12. It has been said that the Exchequer, in its relations to the trading departments, would model its accounts upon the accounts of a bank. It is therefore quite consistent to say that the kind of control which the Treasury should exercise over the trading departments should be modelled upon the control which a bank exercises over its clients. A bank does not control the day-to-day operations of its clients, but it does exercise control through its readiness or unreadiness to make advances to them. In fact, it is inevitable that the Treasury will exercise this sort of control over those nationalized industries which are dependent on it for funds;² the object of bringing the results of the nationalized industries into the budget is to enable that control to be exercised in a more orderly and intelligent way.

¹ See below, pp. 79-80.

² Especially the Coal Board and the Raw Cotton Commission; other nationalized industries have powers of borrowing on the market.

13. It is, of course, desirable that the Treasury, in exercising its 'banking' control, should take into account wider considerations than could be taken into account by an individual bank. A bank, before it grants a loan, has to decide whether it is probable that the loan can be repaid out of eventual profits; the Treasury may sometimes grant a loan even though the prospects of repayment out of profits are poor, because it is public policy to present a contraction of the industry, and because it is considered wise to retain a claim on eventual repayment, which would be abandoned if a subsidy were given outright. In these ways the Treasury should be prepared to be an easier source of funds than a commercial bank would be; but it ought to be prepared, on occasion, to be stonier-hearted, since it ought sometimes to refuse opportunities for 'profitable' lending which a commercial bank might find it hard to refuse, when it was deemed desirable to postpone expansion in the national interest.

14. There is one form of control which the Treasury exercises over the administrative departments (and which, under our plan, it would continue to exercise), but which could not and should not be exercised over the trading departments by the Treasury 'bank'. This is the detailed control over the departments which is designed to see that money is exactly spent on the purposes and in the ways for which it has been appropriated. Detailed control of this sort is altogether inconsistent with business enterprise and with business efficiency. It cannot be applied to the nationalized industries, and it would be better not to apply it to any genuine trading department. (One is not quite so sure about the case of a 'semi-trading department', which might be given a trading account by convention, as in the instance of roads which we discussed above.)¹

15. All the same, this sort of control cannot just be wished away; it is an attempt at the solution of a problem, and the problem remains. Even in the case of the independent business company, accounts have to be audited; and one of the main purposes of auditing is to safeguard against misappropriation of

¹ It may indeed be said that when any trading department is normally dependent upon outright subsidies, the control on it would have to be tightened up.

funds, which does not only include wrongful embezzlement, but also the use of the company's funds for purposes other than those for which the company was formed. The rules which are applied to limited companies under this heading have become rather elastic, but they have by no means disappeared. It has, however, been possible to allow them to become elastic, because the personal financial interest of some directors (at least) in the companies they administer is usually available as an incentive against misappropriation.

16. In the case of the public corporation, or Trading Department, this incentive is not available; and mere moral uprightness is not a sufficient substitute. It is quite conceivable, for instance, that a number of public boards might, from the highest motives, start developing social services of their own; but in so doing they would be using the public funds, which had been committed to their disposal for another purpose, to further an object which Parliament had already provided for, to the extent which it thought fit, in another way. This sort of thing ought to be prevented,¹ but it does appear that it would be better prevented by an elaboration, and intensification, of the checks provided on private business by accountants and auditors, rather than by an attempt to adapt the traditional system of Treasury control to the control of public enterprises, for which purpose it is quite clearly ill-suited.

17. I now turn to consider a form of control which would also be affected by our proposed reform of budget accounting, but in a different way. The traditional form of accounts has been designed, not only to facilitate the control of the Treasury over the departments, but also to facilitate and to guide the control of Parliament over the Treasury. A comparison of British experience in this matter with that of most other countries makes it apparent how excellent are the rules under which the parliamentary control over finance is organized in the British system. As we shall see, these rules have been seriously weakened in recent years; and I do not think that the

¹ This is not to say that public corporations may not sometimes be used as agents for the development of social services, as the Tennessee Valley Authority has been used in the U.S.A. But their powers in this direction[^] should be strictly defined and limited; it would be highly desirable that they should have specific funds allotted to them for such purposes.

weakening is merely a result of the war. It is unlikely that it is going to be possible to restore the rules in their old rigour, for they are not altogether in keeping with the principles of government finance now generally accepted. But it is important that their virtue should be, as far as possible, preserved. How far would it be affected by our proposed changes ?

18. The first matter which has to be considered is the proposed separation of the Exchequer account into a revenue account and a capital account. Constitutionally, every issue from the Exchequer, of whatever kind, has to have parliamentary sanction; sanction is needed whatever the form of the issue, whether it consists of a payment of wages, a purchase of goods, a grant, or a loan. But there is a distinction between those items which need sanction every year and those which do not. Several of the items which we should put on to the capital account do not, at present, require sanction each year; thus, for instance, the Treasury has power to make advances to the Coal Board up to a total of £150 millions within five years from nationalization, and does not need to get this power renewed in each finance Act. It would, I think, be very unfortunate if this practice were generalized for all capital items. Parliamentary control over expenditure would be seriously weakened, and the opportunities for discussion of government policy would be seriously curtailed. There is certainly no reason, on the economic side, why this should happen. Economically, it would be very desirable that the advances which the Treasury proposed to make to the trading departments should be forecast in the Estimates. These proposals are all part of the 'Plan' for the year; they should be set out and they should be discussed. Presumably there are various ways in which this end could be reached in terms of parliamentary procedure. Parliamentary control over the capital items should be every bit as direct as it is over the revenue items.

19. There is another related point on which there would have to be some change; or perhaps it would be better called a formalization of a change which has already been happening. Traditionally, every issue from the Exchequer has had to be met by an appropriation of revenue; that is to say, it has in principle been the business of Parliament to find revenue to

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meet every issue made. Ordinarily it has been understood that the revenue in question will be found from taxation; and it is by means of this principle that in normal years the British Budget has always been kept approximately balanced—surpluses and deficits arising only through imperfect forecasting (of expenditure or of revenue). In abnormal conditions, however, it has been possible for Parliament to lay down that certain expenditure shall not be met out of taxation, but from borrowing; war expenditure has on occasion been treated in this way. And in recent years it has become customary to treat in the same way some other special expenses which appear to be of a non-recurrent character. It has always been necessary to get parliamentary sanction for this treatment, but the necessary sanction has been given in recent years with increasing freedom.

20. This is the origin of the 'below the line' items in contemporary budgets. 'Below the line' payments are those which Parliament has sanctioned to be met out of borrowing. Since Parliament has not given this sanction on any particularly clear financial or economic principle, the items which appear 'below the line' are somewhat heterogeneous. Some of them, like war damage payments or excess profits tax refunds, are what we have called capital transfers;¹ others, like the advances to local authorities and the advances to the Coal Board and the Raw Cotton Commission, are loans which would figure as capital items in a proper capital account. But by no means all loans, which would figure as capital items in a proper capital account, are put 'below the line'; there are several similar items which are hidden away in Civil Supply Expenditure 'above the line' (such, for instance, as the 'Loans to Allies, &c.', which was disentangled from it in the 1948 Alternative Classification).

21. 'Below the line' receipts can be still more arbitrary. The principal type of receipt which must go 'below the line' is receipts from borrowing; and when advances have been made 'below the line', the repayment of those advances must go 'below the line' also. Then there is the small item of 'interest outside budget', which consists of revenue earmarked to meet certain interest charges which appear on the other side. To these items, however, the Treasury can add any other items it

¹ See above, p. 41.

likes. Thus in 1947-8 the gifts from Australia and New Zealand were put 'below the line' to mark their exceptional character.

22. It is evident that the development of 'below the line' payments and receipts, not segregated on any clear principle, threatens to deprive the budget surplus, calculated from the 'above the line' items only, of any clear meaning. That this is so has now been recognized by the Chancellor. It will, however, at this point be a thoroughly natural development if the 'below the line' items come to be replaced by a proper capital account. The advances and repayments, which do belong to a proper capital account, are in any case due to become the main items 'below the line' as soon as the end-of-war payments are cleared up. What is desirable is that the remaining end-of-war items (war damage payments, excess profits tax refunds, and post-war credits) should at once be put back 'above the line' and that any advances which are hidden away in Supply Expenditure should be brought down 'below the line' in their place. In this way the evolution of the 'below the line' items into a proper capital account would be completed.

23. A development of this kind would, however, sooner or later bring parliamentary practice face to face with a major issue. According to the traditionally accepted principles, 'above the line' items have to be met out of taxation; thus it is constitutionally impossible to budget for a deficit in the sense in which we have been using that term when talking about the Exchequer surplus or deficit. But occasions will arise when it will be desirable, and indeed imperative in the interests of employment policy, to budget for a deficit in this sense. Doubtless the lawyers would be able to find a way round this difficulty on the legal level; but it is not too soon to begin thinking about ways round it. For it is a major matter of principle, and makeshift solutions might do serious damage.

24. It would be very unsatisfactory indeed if the knot were cut by a mere abandonment of the principle that 'above the line' payments (interpreted as payments which fall on the revenue account of the Exchequer) must be met out of taxation. For that would mean that the Treasury would lose its main defence against excessive demands upon it. Hitherto, excepting in time of war and post-war resettlement, it has always been

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possible for the Chancellor, when faced with a proposal to spend (say) £10 millions on some desirable object, to reply in these terms: 'If I agree with that proposal, I shall have to find £10 millions of additional revenue. Where am I to find it? Is there any source of revenue still open which I can expect the country to accept as the price of this expenditure?' The answer to this last question might be yes or no; but if it was answered in the affirmative, the decision to spend the money would have been made with a fair counting of the cost. But now, if the principle of meeting expenditure out of taxation is wholly abandoned without any other principle being put in its place, the cost would cease to be counted. Additional expenditure could always be met by enlarging the deficit.

25. This is a very real danger which must somehow be avoided. For it is not at all implied in modern views on employment policy that deficits should be unlimited. Even in conditions of threatening unemployment, there is a limit to the excess of expenditure over revenue which is economically justified. To exceed that limit will make it necessary to cut down private expenditure by direct controls (which may be as unpopular as taxes) and will also affect the balance of payments in an adverse direction. Thus even if it is not always desirable, on the new principles, that the budget should be balanced in the old sense, it is still necessary that it should be balanced in a new sense; the excess of expenditure over revenue should not exceed a limited amount, that limit being determined by the economic situation.

26. This line of thought leads one to make a tentative suggestion. Would it be possible, instead of abandoning outright the principle that current expenditure must be met out of taxation, to maintain it, but to modify it by a single, vital, qualification? This qualification would be to the effect that a 'Stabilization Contribution' might, when necessary, be introduced as a source of revenue; a contribution which would be financed by borrowing (and therefore shown, as a deficit would be shown, on the capital account). It would be laid down that the amount of this stabilization contribution must be determined by economic considerations, by reference (that is) to the state of employment and the balance of payments. Except that the

stabilization contribution would be introduced, when appropriate, on the revenue side, the budget would have to be balanced; loan finance would be limited by the amount of the stabilization contribution. On appropriate occasions, when it was desired to repress inflationary tendencies arising outside the budget (as at present), the stabilization contribution would be replaced by a stabilization charge on the other side of the account. This, indeed, raises no constitutional issue (for there is no objection on grounds of traditional principle to an over-balanced budget); the one device would, however, seem to imply the other.¹

27. A formal device of this sort could not of course affect the realities of the situation in any direct manner. But there is nevertheless something to be said for having a formal procedure which guides the mind in the right direction, a procedure which regularly reminds us of dangers by automatically calling them to our notice. It is essentially this which has been the function of the great traditional Standing Orders on which the financial procedure of Parliament is based. It is worth considering whether the new financial policies, to which the nation appears to have become committed, would not work more effectively if they could be served, as the old policies were served, by similar devices.

¹ It would not be possible to maintain that *all* planned deficits should be dignified as 'stabilization contributions'. In war-time, a government would still have to budget for a deficit, as up to the present; stability then ceases to be a primary consideration, and inflationary tendencies can be repressed (to some extent) by direct controls.

THE BUDGET AND THE ACCOUNTS OF THE
NATIONAL INCOME

1. SINCE the early years of the War it has been widely accepted that the ultimate object of budgetary policy is to contribute to economic stabilization—that is to say, the budget should provide, as far as possible, a counterpoise to the tendencies to excessive or deficient saving, which may be detectable in the private sector of the economy, and which (if unconnected) would make for unemployment or for inflation. And it has been recognized that the best way of seeing what budgetary policy is required, at any particular date, for this purpose, is to look at the budget accounts against the background of the National Income and Expenditure. It is, I think, sometimes imagined that the construction of a correct set of national income accounts will make the answer to the question of what budgetary policy to adopt almost automatic. It is only necessary to 'fill the (inflationary or deflationary) gap' and all will be well. That, I believe, is far from being the case. The problem is very much more complicated. I shall have something to say about the complications in my final section; but the qualifications which we shall there introduce do not in the least affect the utility of national income calculations as a guide to budgetary policy. Thus, in the present section, I shall confine myself to an examination of the relation between a budget, of the kind which I have been suggesting, and the accounts of the national income, more or less as they have been set out in the successive National Income White Papers.

2. It has become increasingly apparent during the last year or two that even here there is a difficult problem. The failure of the budget accounts to come into connexion with the account of the National Income White Paper has become glaringly obvious. The most extreme discrepancy, superficially quite flabbergasting, appeared in the 1948 budget, when the Financial Statement showed a surplus of £036 millions, corrected in the 'Alternative Classification' to £338 millions, while the National Income White Paper, published at the same time, showed a

deficit of £537 millions! When one considers that before the War a deficit of £20 or £30 millions was a very serious matter, the enormity of these figures, even allowing for the changed value of money, becomes apparent. 'They reel to and fro, and stagger like a drunken man, and are at their wit's end/

3. The principal single reason for such vast discrepancies is the discrepancy in timing.¹ The national income accounts are made up for the preceding calendar year (January to December) while the budget accounts are made up for the financial year (April to April). The national income accounts are accordingly lagged approximately three months behind the Budget accounts—the budget accounts running (in the present case) from April 1947 to April 1948, while the corresponding national income accounts run for the calendar year 1947. When, as happened in this case, there is a very large difference between the state of the Exchequer in the first quarter of the one year (1947) and its state in the first quarter of the other (1948), the two accounts cannot be expected to square; owing to the lack of co-ordination in this respect, the utility of the whole procedure is almost destroyed. This is a defect which must be remedied, if the greatest of economic inventions is not to degenerate into a ritual. It could be remedied, either by putting the national income accounts upon a financial year basis, or by returning to the original practice of issuing the national income accounts on a quarterly basis. If this latter alternative were chosen (and probably it would be the better alternative) some sacrifice in precision would be involved, since the allocation of profits over the four quarters of the year would be inevitably arbitrary, and the national income figures for the last quarter of the financial year (or first of the new calendar year) would, of course, be tentative. But the resultant figures, if less precise, would have infinitely more use than those provided at present.

4. Subject to this qualification about timing, and subject also to one other qualification of great importance, I think that a budget drawn up in the form here proposed would fit in to the

¹ See Tables 3 and 4 in Tabular Appendix, from which it appears that the Exchequer Budget, reclassified on principles which are nearer to those of the White Paper, may have been approximately balanced. Thus about £500 millions of the gap may have been due to timing.

National Income accounts as well as can be expected. The other qualification is the following. For national income accounting, which seeks to classify the total expenditure of the economy into Consumption Expenditure and Investment Expenditure (or expenditure on asset formation), government expenditure has always provided a knotty problem of classification. In the case of private expenditure, accounting practices provide a rough and ready distinction between expenditure on income account and expenditure on capital account; although economists may sometimes be tempted to refine upon the accounting practices, it has generally been recognized that where private expenditure is concerned, it is safest to take the accounting conventions as our guide. In the case of public expenditure, on the other hand (or at least over a large sector of public expenditure), there has, up to the present, been no such ready line of demarcation. It has therefore been inevitable that national income accountants should exercise their discretion, classifying government expenditure on goods and services into expenditure on current account (or what is in effect consumption expenditure) and expenditure on capital account (or what is in effect investment expenditure) according as it seems to them to be analogous to what would be reckoned under the one heading or the other in the accounts of private businesses or private persons. This procedure has been perfectly defensible, and indeed unavoidable, in the situation as it has existed up to the present. But so long as it is maintained, it is impossible for the budget accounts and the national income accounts to 'square'. For the national income accounts are being based upon a distinction which is unknown to the compilers of the budget accounts.

5. On our budget plan, there would be a distinction between government expenditure on current account and on capital account. But it would not be an economist's or a statistician's distinction, based on an analogy with private accounting; it would be an administrative distinction, based upon administrative convenience. Thus there is no necessary reason why it should correspond at all precisely with the classification which has been adopted by the national income statisticians. It might do so, but it might not. For instance, the national income

accounts do at present reckon government expenditure on 'Roads and Buildings' as capital expenditure. Translating this into our terminology, this means that they reckon the Roads Department and (presumably) the Office of Works as trading departments. Now we have seen that there may be a good case for reckoning these departments as trading departments. But if, on our plan, they were to be treated as trading departments, that would involve consequences which would go far beyond the accounts of the national income. Thus the decision to reckon them as trading departments might or might not be taken. If it was taken, then (from the point of view of the national income accounts) all would be well. But if it was not taken, then, on our plan, the Central Statistical Office would have to refrain from treating expenditure on roads and buildings (through the Roads Department or the Office of Works) as capital expenditure. For the accounts of the national income would only square with the budget accounts *if all expenditure of administrative departments were treated as expenditure on current account.*

6. How much would be lost if it thus became necessary to exclude these kinds of government expenditure from the nation's capital expenditure (or investment expenditure)? Something, certainly; but much less than would be gained from the consistency secured by adopting the same convention on each side. For *at bottom* what the national income accounts have to show is the way in which an effective demand, sufficient (and no more than sufficient) to purchase the national output, is being secured. In the case of private demand, the distinction between consumption and investment expenditure is all-important, because they correspond to different sources, the one chiefly arising from the private accounts of individuals, the other from the business accounts of firms. But in the case of government demand, the distinction is much less important, for both 'consumption' and 'investment' expenditure come from the same source. The line between them is inevitably an arbitrary line. Useful and intelligible accounts could be constructed with the line drawn in several different places.

7. It is not, of course, to be denied that an account of the National Income and Expenditure, based upon a line between

administrative and trading departments which was economically very artificial, would be less convenient for many economic purposes than one which was based upon a line more satisfactory to economists. It would, for instance, need some adjustment before it could be used to give an indication of the rate at which capital, in an economic sense, was being accumulated. This would be a serious defect, and might have unfortunate repercussions upon the economic side of administration as well as on academic study. Nevertheless, the main reason why the government spends public money in constructing tables of National Income and Expenditure is because it is believed that they may be of assistance in the problem of budgeting; and surely there can be no question that efficiency in this use is the first demand which ought to be made of them.

8. I feel very strongly that the main tables of the National Income White Paper ought to run in terms which harmonize with those in which the budget can be presented; and if this means that they cannot include in their 'Investment' figure the whole of what one would like to reckon as public investment, then the defect must be accepted. But even though this happened, there would certainly be no reason why the additional items should not be covered in subsidiary tables; and it would be very desirable that they should be. In order that these subsidiary tables should be properly constructed, capital accounts for the semi-trading departments (Roads and Works, and maybe some branches of other departments classed as administrative) would need to be prepared. Thus there is a strong case for the preparation of such accounts, even if the authorities are not willing to use them for budgetary purposes. Ideally, of course, they would be used for budgetary purposes; and then the budgetary concept of investment would harmonize with the economic concept. But if that cannot happen, it would be better to have some cumbrous duplication than to lose information which would be of real use.

9. Once we accept the convention of treating the expenditure of administrative departments as current expenditure, the fitting of the budget (in our form) into the accounts of the national income proceeds fairly smoothly. One difficulty does, it is true, remain, but it is a difficulty which is inherent in the nature of

the case, and we can invent a satisfactory way of dealing with it. Otherwise all is plain sailing. In order to show this, something will have to be said about the technique of national income accounting. It will not be necessary for this purpose to draw up an elaborate set of tables; we shall only have to remind ourselves, very briefly, of the principles on which such tables are set up.

10. Any economic entity, whether private individual, firm, government department, or other authority, can be thought of as having (i) an income (or revenue) account, which may be thought of as being its contribution to the economic identity 'Income equals Consumption plus Saving'; and (2) a capital account, which is in a similar way its contribution to the identity 'Saving equals Investment'. The accounts in question could actually be written in the form of their corresponding identities in an economy in which the component entities had no economic relations except trading relations—so that they only dealt with one another by buying and selling goods and services. In fact, we have two other sorts of relations to work in. In the first place there are relations of borrowing and lending. Thus a private individual may save, even though his investment (in real assets) is zero; the difference is lent (either in the form of a direct loan to some other entity or in the form of a purchase of shares, which we here regard as a form of lending). A company may invest in real assets beyond its saving (its undistributed profits) by borrowing (including in borrowing the raising of additional share capital). And when such borrowings and lendings have taken place, the interest and dividends which result have also to be considered. Interest and dividends (on past 'borrowings') will have to be deducted from the profits of a firm in order to get its residual income; the income of the private individual may be increased above his earnings by the amount of interest or dividends received. The borrowings and lendings of public authorities have to be treated in an exactly similar way.

11. Secondly, we have to allow for unilateral transfers between the entities—transfers of which the simplest case is the outright gift from one private individual to another. Another simple type is the retirement pension paid by a firm. The most

important transfers, however, are the taxes (or compulsory gifts) paid by private persons and firms to public authorities, and on the other side the grants, subsidies, pensions, and cash benefactions paid by public authorities to other authorities as well as to private individuals and firms. Income-tax, for instance, appears as a transfer from private accounts to the Exchequer account; war pensions appear as a transfer from the Exchequer account to the accounts of private individuals.

12. The full income and expenditure account of any entity will therefore take the following form (allowing for borrowing and lending and for unilateral transfers) :

TABLE V

Income and Expenditure Account for any Entity

Earnings of factors of production in possession of entity (wages, profits, rents, &c.)	A	Consumption net of indirect taxes (i.e. at factor cost)	a
Incomings from other entities in form of interest or dividends	B	Outgoings to other entities in form of interest or dividends	b
Incomings from other entities in form of gifts, pensions, taxes, or subsidies	C	Outgoings to other entities in form of gifts, pensions, taxes, or subsidies	c
		Saving	$ABC-abc$

The above form is perfectly general, but when it is applied to the private individual item *b* will often be zero (unless, for instance, he has a mortgage on his house). When it is applied to a purely profit-making firm item *a* will in principle be zero. Otherwise it can be applied to either case. It can also be applied to the accounts of public authorities. The accounts of trading departments will be similar in form to those of private firms. The Exchequer account, in the form described above, will also fit into the same categories; the method of fitting it can be seen by reference to the lettering used in Table I, which has been made to harmonize with the classification here proposed. The *A* item in the Exchequer account will consist of no more than the income from such items of public property as are not allocated to trading services; the main items here will probably be rents. As we have seen, there will be some revenue under *B* (interest and dividends from trading departments and other public investments); but the main source of revenue (taxes)

will come under C. On the expenditure side, expenditure by the administrative departments on goods and services will be reckoned as public consumption under *a*, interest on the national debt will appear under *£*, grants, subsidies, and pensions under *c*. The Exchequer surplus, as we have defined it, would thus appear to be identified with the saving on Exchequer account.

13. But here we come to our difficulty. I have assumed, in the above table, that all transfers from one entity to another are reckoned, and reckoned in the same way, into the income and expenditure account of each entity (reckoned, that is, under C or *c*). If this is done, then, when the accounts of the various entities composing a nation are consolidated (which is what we do when we make a table of the National Income and Expenditure), all transfers from one entity to another within the nation will cancel out, just as all interest and dividend payments from one entity to another will cancel out. The consolidated table of National Income and Expenditure will therefore read as follows:

TABLE VI

National Income and Expenditure

Earnings of factors of production	A	Consumption at factor cost	. a
Incomings from abroad in form of interest or dividends	B	Outgoings abroad in form of interest or dividends	. 6
Incomings from abroad in form of gifts or tributes	C	Outgoings abroad in form of gifts or tributes	. c
		Saving	. ABC—abc

In practice it is convenient to define the national income as the sum of *ABC* minus *b* (interest payments on foreign liabilities) and minus any compulsory payments under *c*. The above table then reduces to the conventional form: Income equals Consumption plus Saving—apart from a possible minor qualification about voluntary grants or gifts to other countries. It is evident that for a closed system, such as the world as a whole, all the items *BCbc* will cancel out on consolidation, so that we are left with the fundamental identity Income equals Consumption plus Saving, without any qualification. The resultant figure for national saving will, on these principles, be the sum of the savings of the separate entities—the sum, that is, of the savings

of private individuals plus the undistributed profits (minus losses) of firms (including trading departments) plus the Exchequer surplus, the surpluses on national insurance funds and the surpluses of local authorities.

14. This is how the consolidation would proceed—provided that we could rely upon all transfers being reckoned into the income account of each entity. In practice, however, this does not happen. The Exchequer, it is true, makes no distinction between transfers on income account and transfers on capital account; and we have not suggested that any such distinction should be introduced into our rearranged Budget. Other entities, both individuals and firms, do, however, make such a distinction. They do not reckon all the transfers with which they are concerned as entering into their income accounts; some of them are put upon capital account. In so far as this happens, trouble will arise.

15. The simplest case of a transfer which will usually not be reckoned as an income transfer is an inheritance. Consider the simple case of an estate which passes at death to a single beneficiary, and leave on one side for the moment the question of death duties. We have then one account (that of the deceased) which is being wound up; if the transfer of the estate was shown on income account, the income account in this its final year would be swamped by a large outpayment under *c*, so that the net result would be to show a large negative saving on the whole account. On the other hand, this large out-payment would be matched by a large receipt under *C* in the account of the beneficiary, so that he would show a large positive saving on his account. When the two accounts were consolidated, then (apart from death duties) the positive and negative savings would cancel out.

16. It is quite obvious that this would be a very inconvenient way of keeping private accounts; nevertheless it is this way which, when death duties have to be considered, gives the correct result. For if, on the passage of the estate, a portion is taken by the government in death duties, we have to deal with a transfer payment which will be reckoned as revenue on income account in the accounts of the Exchequer, and which must therefore appear in the income account of the taxpayer if the

consolidation is to proceed satisfactorily. On the above plan, that will happen. The account of the deceased will show a large negative saving, which will be partially (but not wholly) offset by the positive saving in the account of the beneficiary. On balance, therefore, there will be a negative saving in the private sector of the economy to the amount of the revenue collected in death duties. On this basis we shall get the correct result.

17. If, however, the transfer of the estate does not appear on the income account of either party, but is regarded as a capital transfer, the position is different. No harm will, indeed, be done as long as no death duties are payable; for the transfer would then cancel out in any case as soon as the accounts are consolidated. But when death duties are payable, we get into trouble. The Exchequer is receiving revenue from a source which does not figure in the income accounts of the taxpayers. From the point of view of the whole economy, the tax is purely an internal transfer, which ought to cancel out; but if it appears on the income account of the recipient but not on the income account of the payer it will not cancel out. Some adjustment has therefore to be made, if the accounts are to be consolidated properly. And here we are faced with two alternatives.

18. It is possible, on the one hand, to maintain that the receipts from such taxes as death duties ought to be excluded from the revenue account of the Exchequer—that because these taxes do not come out of the income accounts of the taxpayers they should be excluded from the income account of the government. This is an alternative which has been recommended in some quarters, but in my opinion it is definitely undesirable. The first object of a public accounting system (so I have been maintaining throughout this paper) is to give a clear and intelligible picture of the government's own transactions. For this purpose it must be based upon criteria which arise out of the government's own transactions, not upon criteria which are relevant only to the other side of those transactions which concern the private sector of the economy. From the point of view of the financial position of the government, an arrangement of accounts which was based upon the principle of excluding capital taxes from revenue would be less meaningful than one

which paid no attention to the distinction. The distinction has of course to be attended to; but the place in which to attend to it is the place where the relations between the public sector and the private sector are considered—that is to say, in the accounts of the National Income and Expenditure.

19. This is the basis of the other alternative. It is perfectly possible, when setting out the accounts of the National Income and Expenditure, to make a direct allowance for the discrepancy between the practice of the taxpayer and of the Exchequer. On this plan it is necessary, when consolidating the national income account, to make a special allowance for capital transfers. The national total of saving ceases to be equal to the sum of personal savings plus undistributed profits (of public as well as private undertakings) plus the Exchequer surplus and the surpluses of local authorities. To this total an adjustment has to be made, consisting (i) of a deduction for taxes received into the Exchequer which have not been allowed for in the income accounts of taxpayers, and (2) an addition for transfers made out of the Exchequer which will not have been reckoned as received in the income accounts of the beneficiaries. Under (i) will be included not only death duties but also a capital levy such as the special contribution, and also stamp duties on Stock Exchange transactions and other transactions on capital account. Under (2) will be included such grants or subsidies as are likely to be treated by the beneficiaries as being of a capital character—grants such as excess profits tax refunds, war damage payments, and such compensation payments as cannot be dealt with on the accounts of trading services—for instance, the compensation to doctors for loss of the right to sell practices. Finally, the adjustment for the difference between tax payments and tax liabilities, so carefully inserted in the National Income White Papers, would come under the same general classification. This is in fact an adjustment for the difference between the tax item in the account of the taxpayer and the corresponding item in the account of the Exchequer—items which in theory ought to correspond, but which, owing to lags in the assessment and collection of taxes, cannot correspond in practice except by accident.

20. In order to see how this adjustment for capital transfers

should appear on the table of National Income and Expenditure, we had better turn for a moment to the capital account. The capital account of a typical 'entity' will take the following form:

TABLE VII
Capital Account for Any Entity

Saving	<i>ABC—abc</i>		
Depreciation	<i>D</i>	Gross investment in real assets.	<i>d</i>
Repayment of debts due to entity	<i>E</i>	Repayment of debts due by entity	<i>e</i>
Borrowing	<i>F</i>	Lending	<i>f</i>
Transfers made into capital account	<i>G</i>	Transfers made from capital account	<i>g</i>
Capital gains (net of losses)	<i>H</i>	Changes in valuation of debts owing to or from entity	<i>h</i>
		Increase in cash	<i>ABCDEF— abcdefgh</i>

An account of this kind can be used, as before, for any entity, including the Exchequer (or its 'Banking Section'). For the Exchequer, as for any other bank, items *D* and *d* will be negligible; and in the case of the Exchequer, items *G* and *g* are also likely to be blank, or will be if the practice of putting all the government's transfer receipts and payments on to revenue account is followed consistently. Nothing will therefore be left in the Exchequer capital account (apart from the balancing saving and cash items) except items *EFef* and possibly *PL*. This is how the account appeared in Table I. An account of this kind can be consolidated with the rest without any difficulty.

21. On consolidation, all capital transfers (*Gg*) cancel out, except those made to or from abroad (which may be treated as negligible), and those made to or from the government. The difference between *G* and *g*, summed over all accounts, is thus equal to the difference between (i) those transfers *by* the government, which the government reckons as current expenditure, but the recipients bring on to their capital accounts, and (2) those transfers *to* the government, which the government reckons as current revenue, but the payers debit to capital account. This is in fact the difference which we have decided to take over to income account when setting out the account of the National Income and Expenditure. The difference between *C* and *c* on the National Income Account (Table VI) is thus

equal, not to the sum of the separate differences $C-c$ on the separate income accounts, but to the sum of the differences $CG-cg$.

22. The savings item on the consolidated capital account for the whole economy (which must of course be identified with the savings item on the consolidated income account) will therefore look after the capital transfers as well as the savings in the narrower sense. The other item which causes trouble is the capital gains or losses ($//$). Such gains and losses do not arise out of the transactions of the year, but are due to revaluations of assets and liabilities—corrections, that is, of items which already stood in the balance-sheet at the beginning of the year, in the light of further information which has become available during the year. Let us see what will happen to such capital gains and losses on consolidation. Those capital gains and losses which are due to revaluations of debts owing from one entity to another within the economy should in theory cancel out on consolidation. Of course it is true that they would not cancel out in practice, because the parties concerned will often fail to carry out the revaluation in question at the same time; but when we are constructing a capital account for the whole nation, we shall only get a sensible result if we assume that such internal capital gains and losses have cancelled out. The remaining capital gains and losses must then correspond to one or other of the following items: (i) Changes in valuations of real assets (including valuations set upon goods not previously valued and writings-off of goods previously valued but now judged worthless), and (2) changes in valuations of foreign assets and liabilities. So far as the first of these items is concerned, it will correspond to a part of the gross investment which is not *real* investment, being simply due to a change in the prices at which the constituent goods are valued, not to any effective increase in the supply of real capital goods or other facilities. It seems, therefore, that the right thing to do with capital gains and losses of this type is to exclude them from the national capital account, making a corresponding adjustment to the gross investment figure on the other side. As for changes in valuations of foreign assets and liabilities, they should also be excluded from the National Capital Account on the same ground. It follows

that with an appropriate adjustment of the definition of gross investment (*d*) all capital gains and losses can be excluded.

23. Of the other items, all internal borrowings, lendings, and repayments will cancel out on consolidation, leaving only those which come or go to or from abroad. Changes in cash balances will cancel out on consolidation except in so far as there is a change in total bank credit, and this will mainly cancel out against a lending or borrowing item in the accounts of the banks. The only change in cash that will not cancel out in this way is that which takes the form of a change in the monetary reserves of the supreme monetary authority (Exchange Equalization Account and Bank of England); this change in reserves takes the form of a gain or loss of gold. The consolidated capital account for the whole nation therefore takes the following form (capital gains and losses having been removed against the consequential adjustment in the definition of gross investment):

TABLE VIII (a)

National Capital Account

Saving	ABC(G)-abc(g)		
Depreciation	£	}	Gross investment in real assets <i>d</i>
Repayment of debts from abroad	<i>E</i>		Repayment of debts to abroad <i>e</i>
Borrowing from abroad	<i>F</i>		Lending abroad /
			Increase in gold reserve
			<i>ABCDEF-abcdef = (m)</i>

It is easy to recognize that the difference *efm*—*EF* represents the balance of payments, favourable when this difference is positive, unfavourable when it is negative. The National Capital Account can therefore be written in the alternative form:

TABLE VIII (b)

National Capital Account

Saving	ABC—abc		Gross Investment in real assets, <i>d</i>
Depreciation	<i>D</i>		(Favourable) balance of pay- ments <i>ABCDEF-abcdef</i>
			<i>(efm-EF)</i>

In the case of a closed economy, the balance of payments must be zero; the capital account therefore reduces to the classical form:

- Saving plus Depreciation equals Gross Investment,
- or Saving equals Net Investment.

VI

BUDGET ACCOUNTING AND BUDGETARY POLICY

1. IT has now been shown how a budget, in the proposed form, would fit into the accounts of the national income. But there are still some things which one would like to say about the use of such accounts for purposes of budgeting—many of them things which are becoming well accepted, some of them accepted in principle but not always well remembered when they should be, few of them seriously controversial, but all of them in some need of statement or re-statement. This seems rather an appropriate place to set down these principles, as the process of doing so will perhaps enlighten some dark places in what has gone before, and will also give me an opportunity for advancing some extra reasons in defence of the classification I have chosen.

2. The crucial problem of budgetary policy, considered as a means of economic stabilization, is presented in a nutshell in the National Capital Account (Table VIII (6)). When a table of that kind is constructed for the year which has ended, it automatically balances; the balance of payments (favourable or unfavourable) automatically equals the difference between saving and net investment. But when the table is used, not for recording past events, but for planning the future, it does not work out so simply. It ceases to be a record, and becomes a question. If it has to be expected that investment will be running at a certain level, can it be expected that enough saving will be forthcoming to finance that investment? If the answer has to be that not enough saving is likely to be forthcoming, then we know (after Keynes and others) what is likely to happen. It is possible, on the one hand, that the difference may be made up by borrowing abroad—by an adverse balance of payments. But it is always unlikely that this will make up the whole difference, and very often it will be necessary to take steps to see that a strict limit is set on the amount of the difference which is made up in this way. In so far as the difference is not made up in this way, the tendency for investment to exceed saving will set up an expansionary movement at home. Such an expansion may be

very desirable if employment is declining, or is already at a low level; but it will be very undesirable if trade is already booming, and the nation's economy is already under strain. Indeed, if in such circumstances farther expansionary forces are allowed to operate, it may become so necessary to check the inflation at home that a deterioration in the balance of payments may be viewed as a lesser evil. The proper object of budgetary policy will then be to boost saving relatively to investment, in order both to check inflation and to check the tendency to deterioration in the balance of payments.

3. If, on the other hand, it is judged that more than sufficient saving is likely to be available to finance the expected investment, the opposite things must be expected to happen. In the first place, one can expect a favourable movement in the balance of payments. But the extent of this favourable movement will be limited by external factors—in particular by the willingness of other countries to receive the exports which we shall now have become more willing to sell. Thus a part (often a large part) of the excess saving may go to produce a contractionary movement at home. In special cases, when the economy is over-expanded, this contraction may actually be welcome; normally it is, of course, to be deplored. There may, indeed, be some circumstances in which a contraction at home is a price which has to be paid for an improvement in the balance of payments, when such an improvement is necessary, and cannot be secured by other means. Usually, however, it will be the proper object of budgetary policy in a time of depression and unemployment (or whenever there is distinguishable a tendency to excess saving which will work in this direction) to find means of boosting investment relatively to saving, or of repressing saving relatively to investment; for in these conditions it will be a shift in that direction which is called for in the interests of stabilization and of employment policy.

4. With these ideas in mind, let us again look at the National Capital Account, in order to see what items in it are capable of being influenced to an important extent by budgetary policy, and if so, in what ways. For this purpose we need a more detailed classification than that which is provided by Table VIII. It is important, for one thing, to show separately the various

sectors of the economy: (a) the Central Government, including trading services and insurance funds, (b) the Local Authorities, (c) the Private Sector, including both private industry and personal accounts. The balance of payments will then appear as a residual. It is, I think, desirable to attach to the central government sector those sources of private saving or dis-saving which arise directly out of the government's financial policy—those capital transfers of which we have said so much. Classified in this way, the National Capital Account would take the following form:

TABLE IX

National Capital Account arranged for budgetary purposes

<i>Central Government Sector</i>	
Exchequer surplus ¹	S_{\pm} (i)
Surplus of profit on trading departments	S_1 (2)
Surplus on insurance funds.	S_i (3)
<hr/>	
Overall Budget surplus	S_1
(Less) Taxes falling on private capital account	$-g_1$
Transfers to private capital account.	G_1 (i)
Additions to tax reserves	G_1 (2)
<hr/>	
Total saving arising out of central government activity	$S_1 G_1 - g_1$
Depreciation in trading departments	D_1
Gross investment in trading departments	d_1
Surplus of saving (or if negative, deficit) arising from central government activity	$S_1 G_1 D_1 - g_1 d_1 = L_1$
<hr/>	
<i>Local Authorities Sector</i>	
Revenue surplus (including surplus on trading departments)	S_2
Depreciation on trading departments	D_2
Gross investment in trading departments	d_2
Surplus of saving (or if negative, deficit) arising from local authority activity	$S_2 D_2 - d_2 = L_2$

¹ If necessary, 'adjusted' (see above, p. 36).

<i>Private Sector</i>	
Personal saving	S_3 (1)
Undistributed profits (minus losses) of private undertakings	S_3 (2)
Depreciation on private undertakings	D_2
	Gross investment in private undertakings d_0
	Surplus of saving (or if negative, deficit) arising through private sector $S_3 D^{\wedge} - d_3 = L_8$
<i>Balance of Payments</i>	
Surplus (or if negative, deficit) of saving arising through central government sector	L_1
Surplus (or if negative, deficit) of saving arising through local authority sector	L_2
Surplus (or if negative, deficit) of saving arising through private sector	L_3
	Favourable (or if negative, adverse) balance of payments $L_1 + L_2 + L_3$

On a table of this kind the problem of budgetary policy is fairly fully displayed.

5. Let us suppose that it is desired to bring about an increase in saving relatively to investment, for purposes of checking inflation and in order to improve the balance of payments; we have seen that an increase in saving relatively to investment will have both effects. The Chancellor's efforts must therefore be directed to increasing the surpluses of saving (or to diminishing the deficits) from the various sectors; that is to say, he must have his eye on the magnitudes which in the table we have marked as L 's. Of these, L_x (the surplus of saving from the central government sector) is the most directly under his control; but (as we shall see) the surpluses of saving in the other sectors (L_2 and L_3) are capable of being influenced to some extent through the budget.

6. An increase in the Exchequer surplus, due either to diminished expenditure, or to increased taxation, will in principle tend to increase the surplus of saving in the central government sector (L^{\wedge} ; it will always do this if it leaves the other items in the capital account of the central government sector unaffected. But it is evident that there are a good many ways in which the Exchequer surplus may be increased, without pro-

ducing any net change in L_{\pm} ; for the increase in the Exchequer surplus may be directly offset by an equal change in one of the other items.

7. It is, for instance, at once apparent that a reduction in the Exchequer contribution to the insurance funds would have no effect on the surplus of saving in the government sector, if that reduction was not accompanied by any change in contributions or benefits, so that the surplus on the insurance funds was diminished by just as much as the Exchequer surplus was increased. Or again, the removal of a subsidy given to a trading service would have no effect if the trading service was allowed to incur a loss of equal amount. (It was for this reason that we maintained that the choice between covering a trading loss by an advance from the Exchequer or by outright subsidy only depends on the question whether it is desirable to maintain a claim for eventual repayment.) That changes of this kind are essentially nugatory should appear at once from the fact that the Overall Budget surplus (or deficit) would be unaffected by them. It would similarly be unaffected by any transfers from public funds, such as the 'raids on the Road Fund' which distinguished the Chancellorship of Mr. Churchill twenty years ago. For transfers of this sort, being purely internal transactions, must on our principles cancel out in the Overall Budget.

8. Changes which affect the Exchequer budget, but cancel out in the Overall Budget, are, however, not the only ones which will cancel out when the total surplus of saving arising out of the government sector is considered. There is a cancelling-out of essentially similar character when the Exchequer's revenue is increased by particular sorts of taxes, and when its expenditure is diminished by the reduction of particular sorts of transfers. This is the reason for attaching these taxes and transfers to the central government sector, as we have done in our table. An increase in death duties increases the Exchequer's revenue, and therefore increases the surplus (or diminishes the deficit) on the Exchequer Budget; but since Death Duties are not paid out of current income, the item 'taxes falling on private capital account' is increased by an exactly equal amount, and the surplus of saving (L_1) is therefore unaffected.¹ The same is true

¹ To this statement there should perhaps be appended a slight qualifica-

of the special contribution imposed in 1948; and the same is true of stamp duties on transfers of property. The same thing is true, on the other side, of the transfers made by the Exchequer to private capital account (war damage payments and excess profits tax refunds). A reduction in these would not increase the surplus of saving in the central government sector, as we have defined it.

9. Another item to which, on our definitions, the same principle would apply, is the Changes in Tax Reserves. It has notoriously often been possible for the Treasury to secure a better showing on the Exchequer account by speeding up the collection of revenue. But this merely means that sums which have already been allocated to the payment of taxes are transferred from the accounts of the taxpayers to the account of the Exchequer. It does not directly affect spending, either on consumption or on investment. Increased revenue, derived from this source, should also be offset when we are considering the whole surplus of saving for which the government is responsible.

10. The range of economies which will increase the surplus of saving from the government sector, and the range of tax increases which will increase that surplus, is therefore considerably narrower than appears if we look only at the Exchequer Budget. In fact, the government can only increase the surplus L_x in the following ways:

- (a) It may diminish its direct expenditure on goods and services through the administrative departments.

tion. The transfer of property to the government, in payment of death duties, does of course diminish the income of the inheritor; but the main effect of that reduction in income is felt in later years, not in the year when the death duties are paid. However, some effect will be felt in the current year; if we suppose that estates are falling in at an even rate throughout the year, then on the average six months' income will be lost in this way. (In view of delays in the disposal of estates, even this is of course an exaggeration of the amount of effective income lost during the current year as a result of the imposition of death duties.) But even if one gives the point its maximum possible weight, the transfer of property to the Crown in payment of death duties could only correspond to an income transfer of (say) one-fortieth or less of the capital sum paid; say £4. millions as against a capital payment of £ 160 millions. Changes in this magnitude are evidently likely to be negligible.

A corresponding point presumably holds about the Special Contribution, and about the capital transfers $G!$ (1) and G_x (2) on the other side. But I think that these refinements may properly be neglected.

- (b) It may diminish its grants or subsidies to bodies outside the central government sector.
- (c) It may prevail upon the insurance funds to diminish their direct expenditure, or it may prevail upon the trading services to cut their current outgoings.
- (d) It may increase taxes falling upon the income account of the taxpayer, including both direct and indirect taxes; an increase in indirect taxes will, however, only tend to increase L^A if the demand for the taxed article is inelastic.
- (e) It may cause the contributions to the insurance funds to be increased, or it may prevail upon the trading services to increase their charges (this last alternative being subject to the same proviso as above about elasticity of demand).
- (f) It may bring about a reduction in the gross investment of the trading departments.

It will be seen that the opportunities for bringing about an increase in the surplus L_x are distinctly limited. An Exchequer deficit can often be reduced by financial prestidigitation, but to diminish a deficit of saving from the government sector as a whole must always be a painful matter.

11. We have, however, still to consider the indirect effects of government finance upon the surpluses L_2 and L_3 . On $Z >_2$ there is not much to be said. In view of the rule that local authorities cannot borrow for current deficits, the actions of the central government are unlikely to affect the revenue surpluses of the local authorities to any considerable extent. A reduction in grants to local authorities will therefore make it necessary for the local authorities to reduce their expenditure, or to increase their revenue from rates; there is no leakage here, and no great possibility of inducing extra saving. The effect on local investment we shall consider later.

12. When we turn to the private sector, we do find a leakage—an important leakage under the head of Personal Saving $\text{£}3(1)$ and Undistributed Profits $S_3(2)$. It is a fairly general rule that taxes falling on income account are likely to be paid to some extent out of saving; thus there is usually a deduction under this head to be set against additional revenue. It is not only a rise in income-tax which may make a man save less; the same is true

of a rise in the tax on tobacco. The imposition of increased taxation on the profits of firms will not usually cause them to reduce dividends by the full amount of the tax, so that their undistributed profits will be affected. The only exception to this rule is the case of a tax which is levied upon an article of elastic demand—which is therefore such that expenditure on the article is actually reduced by the tax. In this case, though most of the expenditure in question will simply be diverted to other forms of consumption, a part may well be saved. Thus a tax of this sort, just because it fails to produce much revenue under S_{iy} will to some extent make up for the deficiency under £3.

Apart from this special case (one can probably assume that the Chancellor will always have a sufficient preference for tangible revenue to make it a special case), taxes on income account will always tend to reduce saving. But it is evident that different sorts of saving will be affected in different ways by the pressure of taxation. If a man is saving for some particular purpose, and he is not put off that purpose by the additional sacrifice imposed upon him, he will pay the tax out of consumption, not out of saving. Again, since people cannot usually borrow to pay taxes, saving will not be affected if it is already zero, and there are no capital reserves to draw on. Otherwise there must almost inevitably be some reduction in saving as a result of increased taxation. But the effect will be larger if the tax falls largely on classes of people who would otherwise be able to save large amounts in the form of undistributed profits. It is for this reason that progressive taxes, which fall particularly heavily on people with a large capacity for saving, have a particularly large offset to be reckoned against them under this head. Thus when surtax rates are high, it is unlikely that much can be secured as a net contribution to the national surplus of saving ($Z^{\wedge}LgLg$) from a further rise in rates of surtax. The rise in tax revenue will be mostly offset by a fall in saving, or a rise in dis-saving, on the part of the taxpayers concerned.

13. The effect of high surtax rates does of course only differ to a small extent from the effect of a capital levy such as the special contribution. In the case of the surtax, which is regarded as an income-tax, we have suggested that the revenue received from it should be reckoned as a contribution to the surplus of

saving through the government sector (L^{-}); but that it should be remembered that this contribution will be largely offset by a fall in personal saving (S_3 (i)). In the case of the special contribution, we have suggested that the whole of the receipts should be offset under L_j ; but if we do so, then we must recognize that there is likely to be some small but positive increase in personal saving accruing on the other side. Indeed, it may be stated as a principle that taxes falling on private capital account have a small tendency to increase saving. But since it is nowadays impossible to insure against death duties in the higher brackets, we may be sure that death duties can only have an appreciable effect in encouraging saving in the middle-income (or capital) groups. Even this is hardly likely to be important. The special contribution, on the other hand, will undoubtedly be treated as nothing more than a rise in the rate of surtax, except in the highest income groups, and can therefore be expected to compress consumption to some extent. But even this effect is hardly significant for budgetary purposes. We undoubtedly get what is effectively the right impression from our device of offsetting directly the revenue from such a capital tax. There would indeed be much to be said for offsetting the revenue from high rates of surtax in the same way; but it is impossible to draw a line between that part of the income- and surtax-revenue which will be mainly offset by a fall in saving, and that which will be offset to a smaller extent. The distinction between income and capital taxes is a relatively firm one; and so it does seem appropriate to draw the line there.

14. I turn now to the effect of budgetary policy on the investment items. This is, for the most part, not brought out in Table IX; for it is mainly a matter of the lending items shown in the capital account of the government (Table III) but which are not repeated in Table IX, from which they have been removed by consolidation. Mainly, but not entirely; for capital transfers like the war damage payments and excess profits tax refunds, which have been reckoned into the revenue budget, have effects on investment which are not altogether dissimilar from the effects of the Exchequer advances shown on the Exchequer capital account.

15. It is the development of the trading services of the central

government, on the one hand, and the canalization of local borrowing through the Treasury, on the other, which have made the banking functions of the Treasury a matter of prime importance in the national economy. At present, as we have seen, these banking transactions are mixed up with the others in the Financial Statement; but though the general tendency of the reforms we have been suggesting would be to widen the separation between the banking functions of the Treasury and its functions as paymaster and revenue-raiser, this should not mean that the banking side suffered any lack of consideration in the preparation of financial policy. A budget speech would be very incomplete which did not deal with this side very seriously. Direct decisions about investment in the trading departments of the central government, and in the trading departments of the local authorities, will of course be made elsewhere than in the Treasury; but the Treasury will have to provide most of the funds for such investment, and is therefore responsible for it, at least at second remove, in the same sort of way as the commercial banks are responsible for a part of the investment of the private sector. We should, indeed, begin to think of the Treasury as being the bank of the public sector; and we should judge its policy in this respect by the criteria elaborated by economists for judging banking policy. If inflationary conditions have developed one of the reasons for this may be that there has been an undue expansion of bank lending. With our present financial structure, symptoms of an undue expansion of bank lending have to be looked for, not merely in the capital accounts of the banks (where there is not much sign of them) but also in the capital account of the Exchequer itself (where there much more possibly is).

16. A preoccupation (perhaps excessive) with the formal structure of Keynes's *General Theory* has led both economists and others to think of this banking expansion too much in terms of rates of interest. But when economic theorists (including Keynes) talk about the rate of interest, what they have in mind is an *index of willingness to lend*; this will partly be reflected in the actual rate of interest charged on a loan, partly in the other terms of the contract, and partly in the willingness to lend at all (to a particular borrower). In this

wider sense, excessive lending is always a matter of the (theoretical) rate of interest being too low; it can well be too low in this sense even in conditions where there is no free borrowing and lending, so that the actual rate of interest charge on loans has become rather conventional. Thus from this point of view, excessive lending is part of the 'cheap money policy'; though from another point of view it is important to notice that cheap money has been one aspect of the rise of the Treasury 'bank', which could not have developed in the way it has done if the Treasury had not financed itself so largely through the floating debt, bearing an almost nominal rate of interest, which enabled it to undercut any other possible source of funds.

17. Although the Treasury has certain powers to develop its banking functions even more widely, it is probably correct, at least for the time being, to think of its loans as being confined, or nearly confined, to the public sector. (This puts on one side its overseas lending, to which we shall return in a moment.) Thus, although the banking policy of the Treasury influences investment by the trading services and local authorities very largely, it will normally have a negligible effect on private investment (d_3). Recently, it is true, the effect of Treasury policy on private investment has not been negligible. For although loans to private industry have been rather exceptional, the large transfers to private industry in war damage payments and excess profits tax refunds must have affected private investment to quite a considerable extent. Unlike loans, these transfers are not made in order to finance specific acts of investment; they only facilitate investment otherwise decided on, investment which must have been, in many but by no means all cases, otherwise approved. Thus they certainly do not increase private investment by their full amount, but that they do increase it somewhat can hardly be doubted. It may be said that the recipients were entitled to these payments, but they were not entitled to them at a particular time. Private investment could have been slowed up if the refunds had been made more slowly.

18. This concludes our list of the ways in which the national surplus of saving can be increased by budgetary policy. It is quite a long list, and fairly complicated; but it does not seem to

be more complicated than it must inevitably be in a system of government which has taken on so wide a variety of functions, and which has carried to such lengths the search for means of finance. A table such as we have given in Table IX, once it became familiar, would serve as a sufficient thread through the maze. Doubtless it could be varied in several ways, and probably it is capable of improvement; but it does not seem to be capable of much simplification if it is to fulfil its function of calling to mind the main considerations likely to be relevant.

19. Having worked through our table for the case, which is still of topical importance, when it is desired to diminish a deficit (or, what here comes to the same thing, increase a surplus) of saving, we have little to add on the reverse case, when budgetary policy is to be used in the reverse direction. Almost the whole of the preceding argument can be read in reverse, and I may leave it to the reader to work out the reversal for himself. There is, however, one point which has not been made in the previous discussion, though it could have been made there. When we look at both sides of the picture together, it is clear that it is an important point; as it has some bearing on the precise classification which we have proposed for our account, it must not be overlooked.

20. One of the ways in which budgetary policy affects private investment is by affecting the profitability of such investment. Heavy taxation on profits, especially when it falls on the margin of profit expected from business expansion, will inevitably repress investment; a reduction in profits taxes will encourage it. Thus while a reduction of profits normally means a reduction in private saving, a reduction which is a stimulating factor (of which we have taken account), this stimulus will in most cases be more than offset by the deterrent effect on investment. Now this principle holds whether the reduction in profits is due to increased taxation or to other causes. Repression of private profit is thus not available as a stimulator; its net effect is likely to go in the other direction. It should be noticed that if the failure of profit goes so far as to compel the firm affected to close down, the closing-down is likely to be attended by a considerable amount of negative investment.

21. In this respect there is a marked contrast between the

behaviour of the 'profits' earned within the public sector and those earned outside. In the case of a public enterprise, its investment is not tied to its profits; it can produce at a loss and still continue its real investment without being affected. Thus a reduction in the profits of public enterprises (or an increase in their losses) is available as a stimulator, as a reduction in private profits is not. This is not an unmixed advantage to the public concern, for public concerns can be a source of grave social loss when economic considerations call for them to be closed down or contracted, but when the government is unwilling to face the resulting unpleasantness. It is, however, a very real advantage that the public concern is able to go on producing at a loss in a general economic crisis, when a private concern, similarly placed, would have to close its doors.

22. This is one of the considerations which I have had in mind when proposing that the government should contemplate the preparation of an Overall Budget—a budget of the central government sector as a whole, including the nationalized industries. But it must be confessed that this distinction, like others in its field, is not absolute. The government can give subsidies to local undertakings, and to private industry; it may, on the other hand, cover the losses of its own trading departments and nationalized industries by giving subsidies to them, just as if they were private concerns. Nevertheless, I think that there is a difference, at least as between private concerns on the one hand and public concerns of all sorts on the other; though with the local authorities getting their finance from the Treasury 'bank' they are perhaps becoming indistinguishable from central government departments in this respect (as in some others). The private-public distinction remains, based on the consideration that concerns which can go bankrupt will inevitably conduct their affairs in a different way from those which cannot.

23. But perhaps we are coming into a world in which no concern will be allowed to go bankrupt. All these distinctions which we have been making seem in the present state of economic revolution to be very fragile; and yet without distinctions how can we get any classification, and hence any order, at all? Distinctions must be based upon rules; and in these days when

the omnipotence of Parliament seems to override all rules, all distinctions seem like shifting sands. And the revolution is being accomplished in the name of Planning—when the last thing which can be planned is a revolution. When the revolution has passed into its New Order, it may at last be possible to plan; but then it will be necessary to have rules, and to keep to them.

24. I have tried in this essay to suggest the lines on which we might construct a new order in the field of budgeting. It is a field in which British practice has traditionally been orderly; and we ought to try to become orderly again. Our traditional practice has not been so very simple; but it has not been a mere piece of muddling-through, it has been deliberately built up with the intention of avoiding certain well-understood and permanent dangers. It did not avoid other dangers, and therefore we have thrown it into the melting-pot. But it remain,' up to us to construct a new system, which shall meet our new needs, and shall not forget the old needs which are still with us.

25. In conclusion, I have one loose end to tie up. The balance of payments, as shown in Table IX, is the balance between all foreign borrowing and lending (including repayments) with allowance made for changes in gold reserves. This is the magnitude which is usually known as the *Balance of Payments*; but it should be noticed that its movements do not tell the whole story about what are called 'balance of payments difficulties'. It is possible for a country to have a favourable balance of payments, and still to get into balance of payments difficulties, because the quality, as well as the quantity, of its foreign lending is a source of trouble. The classical instance of this is the 'borrowing short and lending long' which figured in the crisis of 1931. But the trouble need not take precisely this form. If Britain borrows $\text{^}10$ millions from Switzerland, and lends £10 millions again to Rumania, the balance of payments is unaffected, statistically considered; but when we remember that the value of the debt from Rumania to Britain is a matter of Rumania's credit, while the value of the debt from Britain to Switzerland is a matter of Britain's, the matter does not look so simple. It is for this reason that the Treasury advances to foreign countries, which should appear in the Exchequer budget

(they began to creep into light in the 'Alternative Classification') and the trading department credits to foreign countries, which should appear in the Overall Budget, require to be watched. They do not weaken the statistical balance of payments (they may even strengthen it, through the stimulus which they give to exports); but they do not always produce perfectly sound assets, so that their character is highly relevant to the balance of payments problem in a fuller sense.

VII

CONCLUSION

1. THE proposals which have been put forward in this essay are not very easy to summarize; for they do not present a clear-cut 'plan', but leave open a number of alternatives. The most important point on which alternatives are left open concerns the line of demarcation between what we have called administrative and trading departments. If all doubtful cases were classed as administrative departments, there would be relatively little change from the present system so far as Treasury procedure would be concerned. The burden of adjustment, in order to secure harmony throughout the government accounts, would fall upon the National Income White Paper, and ultimately upon the other statistical and planning activities of the government. On all that side, there would be a danger of serious loss; but presumably it would be possible to take special steps to reduce that loss to a minimum. This, we may say, is the conservative solution—if it is possible to use that word about a political matter in what is obviously not a party sense.

2. The radical solution would be to treat all the doubtful cases as trading departments. This would simplify the statistical problem and would doubtless lead to more efficiency and better co-ordination on the statistical side. But it would cause more trouble at the Treasury end and it would involve some overhauling of the apparatus of parliamentary control. These difficulties are not, I think, insuperable; but they would have to be faced. Between these two extremes, compromises are possible; any compromise would leave considerable difficulties on each side, and it is rather a question whether enough could be gained on either side from a compromise solution to make it worth while. For my own part, however, I should not be averse from compromise. My own first preference would be for the radical solution; but if that is not attainable, at least at once, I should prefer to see some movement in that direction, hoping that it might be followed by a further movement later on.

3. *The Radical Solution.* Let us look at the consequences of

treating all the doubtful departments as trading departments. This would involve the construction of accounts on commercial principles for all such bodies as the Roads Department and the Office of Works and even (in strictness) for all those special activities of other, mainly administrative, departments in which an element of buying to sell again could be detected. The relation of the Exchequer with these departments or accounts would then consist (i) of the payment of subsidies to them, which would figure, like subsidies to private industry, on the revenue account of the Exchequer; and (2) of the making of advances, which would go on to the capital account of the Exchequer. With the circle of administrative departments so severely restricted, the Exchequer account would become much less significant, as a statement of the financial position of the whole government, than it purports to be at present. It might be possible, by very careful budgeting and forecasting, to vote just such subsidies as would cover the actual deficits of the trading departments, so that the surplus (or deficit) of profit, after allowance for subsidy, would be kept small. But in principle the Exchequer account would claim to show no more than the subsidies as expenditure on revenue account; a further account (which we have called the Overall Budget) would be needed to show any surplus or deficit on the trading departments which fell outside the Exchequer account.

4. On this plan, it would be relatively easy to construct tables of government revenue, expenditure, and investment, which would fit in with the accounts of the national income, as commonly understood. On that side things would go relatively smoothly—much more smoothly than at present. And this would become a matter of much greater importance than it appears to be, while we continue on present lines. For with the decline in the importance of the Exchequer account, the statistical estimation of the government's position (the Overall Budget itself being in some degree a matter of statistical estimation) would take the centre of the stage. It would probably be necessary in practice that the Overall Budget should appear in conjunction with the National Income White Paper, rather than in conjunction with the Financial Statement. It would be to the White Paper that we should look for the com-

plete statement of the government's financial position. But for this change to be possible, the transformation of the White Paper on to a financial year basis would be essential. At the very least, it would be necessary to have those items in the White Paper which constituted the Overall Budget set out for the financial year. And the more the other items could be put upon the same basis, the more lucid would the whole proceeding become.

5. Parliament, however, exercises its control over finance through the Exchequer statement, not through the National Income White Paper. It would therefore be most important to take special measures to see that the decline in the importance of the Exchequer statement did not result in a weakening of parliamentary control. One of the things which would be necessary for this purpose would be a tightening-up of the parliamentary control over such issues from the Exchequer as were placed on capital account. They should not be treated as loosely as 'below the line' items are treated at present. If the Exchequer is to develop banking functions, its exercise of those functions ought to come up, more regularly than it does at present, for parliamentary criticism and approval.

6. *The Conservative Solution.* Now let us go to the other extreme and assume that all doubtful departments are treated as administrative departments. In order to bring out the consequences of this alternative as strongly as possible, I will interpret it very rigidly, and suppose that not only roads and works, but also the new trading departments such as food, are treated as administrative departments. If this were done, the financial statement of the Exchequer would retain its primacy; it would be the National Income account which would suffer. Some reforms in the Exchequer statement could indeed still be carried through. It could still be separated, on a clear principle, into a revenue and a capital account. But the capital account would be very restricted in its range. It would include fewer items than those placed 'below the line' in the conventional statement, or than those reckoned as 'Capital, &c., Items' in the *Alternative Classification*.¹ Even for such a reclassifica-

¹ It would correspond closely to the Exchequer account as shown in Table 3 below, excepting that (in consequence of the extreme definition

tion, some adjustment in parliamentary practice about 'below the line' items would presumably be necessary, but it could be quite a small matter compared with the changes necessary to accord with the other solution.

7. Although, with this conservative solution, the Exchequer statement would retain its central position, it would still fail to give as complete a picture of the government's finances, in relation to those of the whole economy, as is needed for modern budgetary purposes. The nationalized industries might be relegated, for purposes of the national income accounts, to the private sector; if that were done, no 'surplus of profit on trading departments' would remain to be considered. But apart from this simplification (if it is a simplification) all the other adjustments, shown in Table IX above, would need to be made, before the 'Surplus of saving arising from central government activity' could be reached. Thus the White Paper would still have a part to play in the assessment of the whole budgetary situation. And the conversion of the White Paper on to a financial year basis would still be required.

8. The changes in practice, both administrative and parliamentary, which the conservative solution would entail, would be a relatively simple matter; the cost of this simplification would fall on the statistical side. The damage done on that side would undoubtedly be very serious. It would indeed be possible to construct national income tables which would be consistent with the Exchequer accounts drawn up on this basis; such tables could conceivably be used quite successfully for all the budgetary purposes with which we have been concerned in this essay. But for non-budgetary purposes, especially for those of more general planning and forecasting, the utility of the national income tables would be seriously diminished if they were drawn up on this plan. It would therefore be necessary to supplement the tables, which had been drawn up with a budgetary slant, with other tables, oriented in the other direction. In those other tables, government expenditure would have to be analysed quite differently, and maybe some other

chosen in the above paragraph) the repayments from trading services, the advances to the Ministry of Food, and (possibly) the advances under the Temporary Housing Acts would be transferred to the revenue account.

items would have to be analysed differently also. The analysis in these other tables would in fact approximate to that which would emerge automatically from the regular accounts if the radical solution had been adopted.

9. In spite of the cumbrousness, and the expense, of having two sets of accounts, it would be necessary, on this alternative, to have two sets of accounts for all the 'doubtful' departments. They would need a cash account, on traditional principles, to be used in their relations with the Exchequer; and a commercial account to be used as a basis for the subsidiary tables in the White Paper, and more generally, for relations with the planning organizations. This double accounting would have to be carried much further than it is carried at present; it would have to cover at the least, such semi-trading activities as roads and works, as well as the trading in food and raw materials. Only by this means could the accounts of the public sector be converted, when necessary, on to an economic, rather than administrative, basis. It could presumably be done; but it would be distinctly costly and distinctly inconvenient.

10. This conservative solution, as I have outlined it, would be an improvement on the present position. It would restore the possibility of consistent budgeting over the whole range of government activities, and would facilitate a budgetary policy which made sense on economic criteria. But the disharmonies, which are such a marked feature of present practice, would be very imperfectly overcome. The disharmonies between the White Paper and the Financial Statement would be overcome, but only at the cost of creating new disharmony within the White Paper itself. Explanations of why the different tables in the White Paper did not square with one another could be given, but the resulting product would be far from easy to understand. What is worse, it would still be the case that the planning organizations and the Treasury would still be talking different languages, so that their activities could hardly be co-ordinated as they should be. For these reasons, it is hoped that we shall move, in this field, in the 'radical' rather than in the 'conservative' direction. A 'conservative' solution, if it is adopted, ought to be no more than a stop-gap.

TABULAR APPENDIX

THE tables in this Appendix are designed to give some, unfortunately very rough and inadequate, idea of what the proposals outlined in the text would look like in terms of figures when applied to a concrete case. For this purpose one has no choice but to use the tables presented with the 1948 Budget, since it was these tables which gave rise to the whole discussion to which the present essay is a contribution. But the unsatisfactory character of these tables, even for this purpose, is brought home to one very forcefully as soon as one tries to use them. The tables in the Financial Statement relate to one period and use one classification; the tables in the National Income White Paper use another classification and relate to another period. The resolution of either of these disharmonies is too great a task for the private investigator. Thus it is not possible to produce a set of tables which are consistent with one another, as they ought to be, and as one would like to make them.

What I shall do in this Appendix is the following. In Tables 1 and 2 the two key tables from the Financial Statement (1948-9) are simply reprinted. Table 1 is the 'Conventional Form of Accounts'; Table 2 is the 'Alternative Classification' introduced as an experiment in the 1948 Budget. Both of these tables refer, of course, to the financial year 1947-8.

In Table 3 I endeavour to reclassify the same figures once again, so as to put them into a form such as that which has been suggested for the Exchequer account (Table 1 above) allowance being made for the special treatment of unspent balances and surplus stores proposed in Chapter III. Having no information about internal interest payments, it has been impossible to follow the form of Table 1 at all exactly. It has thus not been possible to make a division between an 'administrative' and a 'banking' section. I have, however, tried to classify the various items, as given in the tables in the Financial Statement, into revenue and capital items according to the principles set out above. No satisfactory line could be drawn between advances to bodies which do, and to bodies which do not, fall within the government sector, simply from lack of information. I can well believe that an Exchequer account, drawn up strictly on my principles, would look decidedly different from that presented in Table 3. But that table is the best I can do with the means at my disposal.

Ideally, one would like to go on from this table to a proper table

of an Overall Budget; that is, however, quite out of the question. There is not the information. Nor is it possible to produce a National Capital Account (Table IX above) which is consistent with these other tables. We have the material for a National Capital Account in the National Income White Paper (Cmd. 7371); but it relates to the calendar year 1947, and its classification is different. Nevertheless, it may be found useful if the figures in the National Income White Paper are exhibited in the manner of Table IX. This is a relatively easy matter, since the White Paper does now give us the outline of a National Capital Account, which only requires a little subdividing by the use of the other tables there provided.

The reasons for the classification adopted in Tables 3-4, when not obvious, are explained in notes at the end of the Tables.

All figures are given in millions of pounds sterling.

TABULAR APPENDIX
TABLE 1. 1947-8 *Out-turn*

Conventional form of Accounts

ABOVE THE LINE

REVENUE		EXPENDITURE	
Inland revenue	1,799	Interest on debt	503
Customs and Excise	1,421	Sinking fund	22
Motor duties	49	Northern Ireland	24
		Miscellaneous	7
TOTAL TAX REVENUE	3,269		
Surplus stores	197	TOTAL CONSOLIDATED	
Trading services	101	FUND SERVICES	556
Broadcast licences	11		
Crown lands	1	Supply: Defence	854
Sundry loans	23	Civil	1,769
Miscellaneous	243	Tax collection	30
		TOTAL SUPPLY	2,653
TOTAL REVENUE	3,845	TOTAL EXPENDITURE	3,209
		SURPLUS	636
	3,845		3,845

BELOW THE LINE

RECEIPTS		PAYMENTS	
Interest outside Budget	9	Interest outside Budget	9
Housing receipts from votes	12	Post-war credits	56
Coal	1	Excess Profits Tax refunds	28
Gifts from Australia and New Zealand	30	War damage	280
Local authorities	1	Coal	28
Cotton	8	Housing	62
		Local authorities	226
		Cotton	14
		Overseas resources de- velopment	8
TOTAL RECEIPTS	61	TOTAL PAYMENTS	711
NET SUM BORROWED OR MET FROM SURPLUS	650		
	711		
TOTAL RECEIPTS	3,906	TOTAL PAYMENTS	3,920

TABLE 3. *Exchequer Account (1947-8), rearranged according to principles of this essay*

REVENUE ACCOUNT			
A.	Crown lands i	a.	'Other' expenditure on goods and services 1,325
	Housing receipts 12		Capital items in civil supply expenditure 55
	Miscellaneous 58	b.	Interest on debt 503
B.	Interest on sundry loans 11		Interest outside Budget 9
	Interest outside Budget 9	c.	'Other' transfer expenditure 1,170
C(i).	Tax revenue 3,269		Post-war credits 56
	Broadcast licences 11		Excess Profits Tax refunds 28
	Gifts from Australia and New Zealand 30		War damage 280
C(2).	Vote of credit balances 112		
	TOTAL REVENUE <u>£3,513</u>		TOTAL EXPENDITURE <u>£3,426</u>
			Exchequer surplus <u>87</u>
			<i>Adjustment for change in departmental balances — £112</i>
			<i>Adjusted Exchequer surplus — £ 2 5</i>

CAPITAL ACCOUNT

	Exchequer surplus 87	e.	Sinking fund 22
E(i).	Repayments by trading:		
	Services 101		
	Coal 1		
	Cotton 8		
E''(2).	Repayments:	f(1).	Advances to:
	Sundry loans 12		Ministry of Food 33
	Miscellaneous 73		Coal 28
	Local authorities 1		Housing 62
			Cotton 14
			Overseas resources 8
H.	Capital gain from surplus stores 197	f(2).	Loans to allies 16
			Local authorities 226
			Argentine agreement adjustment 85
F.	Borrowing <u>14</u>		
			<u>£494</u>
			<u>£494</u>

TABLE 4. *National Capital Account (arranged for budgetary purposes) Calendar year 1947*

CENTRAL GOVERNMENT SECTOR			
£5(1).	Exchequer surplus . . .	— 537	
£2(2).	Surplus of profit on trading departments . . .	0	
£1(3).	Insurance fund surplus . . .	83	
S₁.	Overall budget surplus . . .	— 454	
<i>Less g₁</i>	Taxes falling on private capital account . . .	— 210	
G₁(1).	Transfers to private capital account . . .	306	
G₂(2).	Additions to tax reserves . . .	— 60	
<i>S₁G₁—g₁</i>	Total saving arising out of central government activity . . .	— 418	
<i>DI.</i>	Depreciation on trading departments . . .	24	
			<i>d^h</i> Gross investment in trading departments . . . — 22
			<i>LI.</i> Surplus of saving arising out of central government activity . . . — 372
LOCAL AUTHORITIES SECTOR			
<i>r^h</i>	Revenue surplus . . .	13	
<i>D₂.</i>	Depreciation on trading departments . . .	113	
			<i>d₂</i> Gross investment in trading departments . . . 345
			<i>L₂</i> Surplus of saving from local authorities . . . — 219
PRIVATE SECTOR			
S₃(1)	Personal saving . . .	655	
S₃(2)	Undistributed profits . . .	320	
D₃	Depreciation on private undertakings . . .	638	
			<i>3.</i> Gross investment in private undertakings . . . 1,697
			<i>L_a</i> Surplus of saving from private sector . . . — 84
BALANCE OF PAYMENTS			
<i>L₁.</i>	Surplus of saving arising from central government activity . . .	— 372	
<i>L₂.</i>	Surplus of saving arising through local government sector . . .	— 219	
<i>I</i>	Surplus of saving arising through private sector . . .	— 84	
			Balance of payments . . . — 675

Notes to Table 3

A. The *Housing receipts* are mainly rents of temporary houses, and are thus quite properly classified here. The general character of the *Miscellaneous receipts* can be ascertained from the National Income White Paper, Table 14, note to item 23. It becomes apparent that a good many of these receipts are interest receipts, which should be classified under *B*. But I have no means of knowing how the items should be divided.

C(i). There is a case for putting *Broadcast licences* under *A*, as a fee for a service. But the White Paper treats them as a tax, and I have followed its example.

C(2). The receipts from *Vote of credit balances* are offset in the *Adjusted surplus* (see above, p. 36).

E. The division between $E'(1)$ and $E(z)$ —repayments internal and external to the government sector—could not be adequately performed. Doubtless many, if not most, of the *Miscellaneous* items are internal.

a. The '*Other*' expenditure item in the *Alternative classification* has been divided as well as could be between expenditure on goods and services, on the one hand, and transfer expenditure on the other. A division, for the calendar year, is given in the White Paper.

Capital items in civil supply expenditure have been kept in the revenue account, on the assumption that the line between administrative and trading departments has been drawn in such a way as to keep this expenditure on the 'administrative' side. This assumption seems to be most in keeping with the general spirit of the traditional statement. If, however, the range of administrative departments was more narrowly circumscribed, it would become possible to treat this expenditure as capital expenditure, transferring it to the capital account, as I have allowed the advances to the Ministry of Food to be transferred.

c. *Excess Profits Tax refunds* and *War damage* payments have been put on revenue account for reasons stated in the text (pp. 10-11 above).

e. *Sinking fund payments* are treated as repayment of debt.

/. The distinction between /(i) and/(a) is inadequate, like that between $E(i)$ and $E'(2)$. If the Ministry of Food is regarded as an administrative department, *advances* cannot be made to it; this item should then be transferred to the revenue account, under *a* above.

If the revenue account is adjusted for the change in departmental balances, then in principle the capital account should be adjusted also. In the adjusted capital account, the adjusted surplus would be inserted in place of the unadjusted surplus; the difference would be made up by an explicit introduction of the change in balances, regarded as a change in the cash balance of Exchequer and administrative departments taken together.

It would, of course, be the adjusted surplus which would be taken across to the Overall Budget.

Notes to Table 4

This table is directly taken from the National Income White Paper (Cmd. 7371), especially from Tables 13 and 14-18.

$S_1(2)$. Since no information is provided out of which one could estimate a *Surplus of profit on trading departments* it has provisionally been entered as zero. If closer examination were to show that such a surplus (or deficit) could be detected, the result might be that an adjustment would have to be made in $S_1(i)$ or in $\text{£}3(2)$.

g_{1t} . Taxes falling on private capital account include death duties (£163 millions) and much the greater part of stamp duties (£50 millions). The £210 millions entered is an approximate sum of these two items.

d_i . Gross investment in trading departments follows the White Paper definition of Central Government Investment, which implies a much broader definition of trading departments than that implied in the Financial statement. (The item is negative because of sales of surplus stores.)

D_i . The depreciation item likewise depends on the White Paper concept of trading departments. If a narrower concept of trading department had been used, both d_i and D_i would have been diminished, and their difference would doubtless have been diminished. There would, however, have been a corresponding reduction in the Exchequer surplus (or increase in the deficit). Thus the *Surplus of saving arising from central government activity* would have been unaffected.

S_2 . The figures for the local authorities sector are taken directly from Table 18 of the White Paper.

$S_3(i)$. The figure for *personal saving* given in the White Paper (Table 11) is £445 millions. This has been written up by £210 millions (the taxes falling on private capital account), which in the White Paper are deducted before arriving at the (residual) savings figure. As I have deducted them already, they have to be written back, and this seems the best place to put them, though there is a question whether some of the stamp duties should not go on to business account.

d_s . The White Paper (Table 13) gives £2,020 millions for the sum of d_1 , d_2 , and d_3 . Separate figures are given (in Tables 15 and 18) for d_i and d_r .

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