National Convention of the Food Manufacturers Federation

MANY YEARS AGO I went to a charity dinner and there was a well known after dinner speaker who told us a funny story. But over the last 20 years I have begun to realise that it was not just funny. The story went as follows: he said 'there are 54 million people in Britain. Of these 35 million are either children or retired folk or housewives wisely looking after their homes. That leaves a working population of about 21 million. Of these 21 million approximately one in three works for the State. That leaves 14 million, of the 14 million a little over half are in the service sector, this leaves about six million. From this figure you have to deduct the one and a half million unemployed, leaving four and a half million. But you must also not forget that every day that goes by a little under two million people don't work because they are ill or on strike or whatever. That leaves about two million, but everybody takes holidays and on a rotating basis, so there are usually about one million people on holiday, that leaves about one million. But of that million well over 990,000 are producing forms that are used by civil servants and others so as to control those who are doing the work. I am afraid that that leaves two of us. You and I and frankly of late I think that you have been rather lazy.'

This joke has become horribly true. If you study the fundamentals of any economy you will find that there must be two principle sections to it. On the one hand there is that part of the economy which produces wealth and on the other hand there is that part of the economy which spends the surplus on behalf of the nation. There is absolutely nothing abnormal or wrong about this. It is quite obvious that any self respecting nation needs a defence force and needs proper facilities for education, health, welfare and for the infrastructure of the nation. Therefore it is absolutely right that one part of the nation produces and that the surplus that it creates be transferred to the other part of the nation which spends it on behalf of the nation as a whole. Let us call the part that produces, 'the productive sector' and the social spending part, 'the social sector'.

One of the ways of transferring the surplus from the productive sector to the social sector is by way of taxation. The government taxes the productive sector and spends the proceeds through the social sector.

I want to emphasize that this has nothing to do with the split between nationalised industries and private industry. Quite obviously the nationalised industries englobe a vast proportion of the productive sector. Perhaps it does not do so efficiently but this is not the purpose of today's discussion. The split is therefore not between the nationalised sector and the private sector but between the productive sector and the social sector.

Of course there will always be arguments about how the social sector should spend its money. Some will believe that more should be spent on defence and others will believe that more should be spent on welfare. This is part of a healthy democratic argument. But, as businessmen, you know full well that there can be no argument about the following proposition: if we want to maintain a balanced budget then the only money that we can spend on the social sector is the surplus created by the productive sector.

Stripped of all the theoretical clap trap, it is quite clear that if the social sector spends more than the surplus that is created by the productive sector then this extra expenditure has not been earned, so it can only come from one of the following sources: either the government can tax individuals or the government can borrow, or it can increase taxation on the productive sector that is to say industry, commerce and agriculture, or it can have recourse to the printing presses and print the difference.

Increasing taxation on individuals, so as to pay for the social cost, in effect means that the government is saying to people 'don't worry about our reducing your take home pay because you are being compensated by the money we are spending on your behalf in the form of social cost'. In other words what is known as the social wage. This has not been acceptable to people in the past and so governments have only been willing to increase taxation on those who earn a higher salary and have not been willing to pay for the social cost by increasing direct taxation on the bulk of individuals.

Therefore the government has had recourse to the three other ways of financing their deficit. Firstly they have borrowed money through the market. This has meant that they have had to compete against industry in the market place for the nation's savings. As a result savings, which should normally have been used to finance productive investment, have been used by the government to finance its social expenditure. Secondly, government has pushed taxation to the point where agriculture, industry and commerce are starved of net profits after tax available for productive investment. The third government method for raising money is recourse to the printing presses which immediately results in inflation. The combination of these three methods for financing those social costs that have not been earned by the productive sector creates a vicious circle. They starve industry of new capital, they reduce industry's profitability, they reduce its capacity to invest and they reduce its power to compete on international markets. Thereby they create unemployment and poverty. And as the productive sector of our economy runs down so it becomes more and more difficult for the government to finance its social expenditure. It is forced to draw from a smaller and smaller surplus created from a diminishing base. And so the cycle gets worse. This is what has happened in Britain during these past 15 years. The social sector has grown nearly four times as fast as the productive sector. The financing of this rapid growth has fallen largely on the productive sector. So profits during the period have fallen from 13.1 % of the national income in 1964 to 7.4% in 1973. Between 1964 and 1973 industrial investment fell by 46.2%. Employment in British industry, even during those extremely good years between 1964 and 1973, fell at a rate of 106,000 people a year. Thus, even before the beginning of the 1974 recession, British industry had already lost 1,300,000 jobs.

Of course this was not too noticeable because, during the same period the social sector increased the number of its employees by 810,000 people.

So throughout this period, be it under Socialist or Conservative governments, there has been a rapid growth of the social sector which has not been paid for by the surplus earned from the productive sector. Instead it has been paid for at the expense of our industry, commerce and agriculture. The result has been a sharp decline in productive investment and a sharp decrease in the numbers employed in industry compensated to a substantial degree by an increase of those employed in the non productive part of the nation. This process has accelerated since the 1974 crisis and we are witnessing a de-industralisation of the nation. This has happened just as our oil is beginning to flow and to produce wealth. But as a result of this de-industralisation this wealth is being used largely to finance imports which we are no longer able to manufacture for ourselves and the unearned part of the cost of the social sector. Another major error was that governments have failed to ensure that the social sector of the economy is efficiently managed. In the hospital service for instance there was a 51 % increase in the number of hospital administrators between 1965 and 1973 and an 11 % fall in the number of beds they were administrating. It took longer for the sick to get into hospital as waiting lists grew from year to year, but the real cost of administrating each bed grew over 60%. In British state education those employed increased by 54% between 1964 and 1974 but only half of those employed actually taught anyone - the other half were administrators, etc.

What is more as a result of unacceptably high levels of taxation on high income earners about one and a half million people have emigrated and one and a half million of the best. A recent American study has estimated that 59% of industrial jobs are lost each decade throughout the USA as a result of technological innovations and improved designs. These have to be replaced by enterprise resulting from new technology, new initiative and new capital investment. But if people with initiative are driven out and if new enterprise is starved of capital because the government is using that capital to finance its social expense, where will the new jobs come from? Who will create those jobs? Enterprise is not the creature of councils, nor of committees, nor of pension fund managers, nor of government. It is the result of individual initiative linked to capital investment.

Of course we have got a million other problems which are discussed every day in the press. But there is a fundamental problem which the government refuses to acknowledge publicly. If the government wishes to increase the amounts spent on the social sector over and above the surplus earned by the productive sector of the nation it must do so by taxing the individual. And this increase in taxation should be realised without damage to the under-lying productive capacity of the economy and without damaging capital investment which is indispensable to growth and long term job creation. If it tries to hide its actions by starving the productive side of the economy of the capital and profitability needed for investment then ultimately it will destroy the very sector of the economy which produces wealth.

This is not a problem which is unique to Britain. Over the last few years we have seen exactly the same thing happen in Chile and in the City of New York. New York is a particularly good example. The City politicians so as to buy votes promised increased expenditure on Social Services. The increase that they promised was greater than the surplus produced by the productive sector of the economy of New York. So the City politicians increased taxation on business. The result was easy to forecast. Those companies that were based in New York transferred their new investments to other States which ran their finances more honestly. Key executives followed that new investment to other States for example in the South-East. Employment in the productive sector of New York's economy fell from 3,130,000 in 1960 to 2,664,000 in 1976: a reduction of 15%. But at the same time those employed by New York City to dispense and administer Social Services increased by 42%. As the industrial base of New York diminished so despite the increase in the rate of tax, the amount of tax harvested barely grew. But at the same time the politicians kept on increasing their social expenditure. This attracted those people in other States who were already living off welfare. So it reached the stage where key productive executives were following new investment away from New York and these people were being replaced, not by tax paying and wealth creating citizens from other States, but by those who were attracted by the high levels of welfare being paid in New York. As the Mayor of Houston put it very concisely, 'Houston is a good place to be if you want to work. If you don't want to work you get a better deal in New York.' We all know the result - the edge of bankruptcy. New York and Britain have one great difference: New York is not able to print new money.

We are now about to benefit from the extraordinarily good fortune of North Sea Oil. We must decide to use this gift in a way which will lay the foundation for the future and not just allow out politicians to buy a few votes.