The UK – too few producers

Fifty years ago when a Labour government came into office early in 1974 they spent more in the public sector, borrowed more, fuelled a subsidy and wage inflation in the nationalised industries and lost control of the nation's fjnances. They had to go cap in hand to the IMF to get a bail out to defend the pound. The IMF made them start a programme of spending cuts. After a disastrous economic performance with high inflation, collapse in growth and many industrial closures they lost the 1979 election.

Labour had got in following the unfortunate short Heath government of 1970-4. The Heath government presided over an inflation followed by a recession along with the US and Europe. They blamed it mainly on the decision of the OPEC Middle Eastern oil producing countries to form an aggressive cartel, cut output and force the oil price up massively . This was certainly very damaging and affected many advanced countries. The UK version was made worse by a miners strike. It was also the case during these events that the UK government put up its spending and greatly increased its interference in the economy with a prices , wages and nationalised subsidy programme. It allowed the Bank of England to expand the money supply by adopting a new monetary policy called Competition and credit control. Large amounts of lending were generated which led to a property bubble.

I mention this not because our current position is the same, though we can learn from the impact of an external energy shock and from bad Central banking in both 1970-3 and 2020-3. I mention it because the period of damaging Labour government led to the publication of the work by Eltis and Bacon, two Oxford economists, pointing out the UK had too few producers. The UK then had a worse productivity problem across the whole economy than we do now. Their analysis showed how the massive overextension of the public sector to 60% of GDP was unsustainable. It led to tax rates that were far too high, which deterred new investment in the private sector and encouraged the brain drain as successful and talented people went elsewhere to avoid the penal levels of income tax Labour imposed. The marginal rate was 83% on earned income and 98% on savings income, effective confiscation. The poor productivity in the public sector was compounded by low productivity in the private sector. Contrary to common belief at the time a lot of business did have modern machinery like the US and Germany, but did not get the same output per person from it.

The Eltis and Bacon main perceptions that too much public spending led to a squeeze on the private sector were correct. When looking at today's problems there are some similarities. It is however important to recognise the fact that the public sector does produce valuable output which is captured in modern GDP figures by assessing the number of pupils taught and the number of NHS treatments undertaken. I will be looking again in future articles at the fast productivity decline in the public sector 2019-23, a new feature, as well as the related lack of good control over public spending growth rates.