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052157160X - The Labour Party and Taxation: Party Identity and Political Purpose in
Twentieth-Century Britain

Richard Whiting

Excerpt

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Introduction: Taxation and political debate

This study brings together the twentieth-century tax system and the history of the Labour Party. Its subject is the way the party used taxation to fulfil its political purpose, and the degree to which that was shaped by its strategy, the capability of the revenue departments, and social attitudes. Political parties have been regarded by some social scientists as making poor use of the powers of government, and this has been true for taxation as for other functions of the state. One study of the period 1965–74, which saw many plans for reform but few results, concluded of both Conservatives and Labour that ‘They could pay more attention to the internal logic of their ideological positions and refine and clarify their objectives.’¹ Not only have parties been poor at deciding exactly what they want to do, but they have also, according to some writers, prevented the achievement of the best policy solutions because of their injection of unhelpfully adversarial pressures into government.² But taxation, even in its details, is so powerfully connected with ultimate political values that it could not be divorced from the party struggle.³ The main body of this book analyses Labour’s performance in this intricate part of government. It does so selectively. I am primarily concerned with the national tax system; local government finance is viewed episodically from this perspective, while special taxes on land have also received less attention than others might think they deserve. It

¹ Ann Robinson and Cedric Sandford, *Tax Policy-making in the United Kingdom. A Study of Rationality, Ideology and Politics* (London, 1983), pp. 233–4.

² This is the theme of Andrew Cox’s *Adversary Politics and Land. The Conflict over Land and Property Policy in Post-war Britain* (Cambridge, 1984).

³ A good example of this view comes from Dick Taverne, a Democratic Labour MP before he left for the ‘middle ground’ of the SDP: ‘They [the better-off] should not be allowed to get rich by avoiding the taxes that the rest of us pay, while others live in poverty. The unpopularity of the Conservatives is partly caused by a strong sense that they have promoted unfairness; for example, in the heady days after 1970, when they first won back power, they proceeded to help their friends, the rich, by handsome tax concessions. Among other things they allowed tax reliefs on overdrafts and personal loans, greatly reduced the tax on unearned income, and restored the separate taxation of certain kinds of children’s income’: *The Future of the Left* (London, 1974), p. 150.

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is the purpose of this introduction to examine the structure of the tax debate within which Labour operated. This explains why the activities detailed in the following pages took the form that they did.

Labour's position in the public eye for much of this century has been as a 'tax and spend' party. Until recently it has shown little sign of being ashamed or concerned about this. Taxes are the instruments upon which a reforming social democracy will inevitably rely. As Labour's Social Justice Commission argued in 1994, 'It is important to restate an old principle: taxes are the contribution that we all make towards building a better society. Taxation in a democratic society is based upon consent; it is a desirable good, not a necessary evil.'⁴

But taxes have also aroused strong feelings the other way. Taxes take 'their' money from the people and consign it to a 'black hole' deep inside government. They are not exchanged for specific services. They are handed over in trust that they will be productively used for services beyond immediate and selfishly defined needs. Although taxes clearly cannot be justified on the basis of payment for specific purposes, they do have instrumental functions, such as the provision of welfare services or economic stabilization, by which they can be measured. But the connection between revenue and expenditure is far from encapsulating the tax debate. Taxes have been argued about for their particular structure and impact, as much as for any output which may result. For the Labour Party taxation has been important for its support of state spending, but it has also had a continuing interest in the characteristics of taxes themselves. This need not have been the case. Redistributive social spending does not require progressive taxation to fund it; indeed, for much of the period, a tax system that was only mildly progressive overall supported cash benefits which were slanted more heavily to the poor.⁵ However, Labour has always had a strong interest in taxes for their own sake, as expressions of the desirable relationship between a government and its people. Taxes should embody trust and consent, and so make a positive contribution to the strength and stability of society.

How has Labour conducted itself in debates about taxes? It has pursued two rather different arguments. The first is for greater equality: that high incomes should be reduced and inequality of wealth lessened in the interests of a more stable society. The Labour Party, it hardly needs stressing, has always challenged the prevailing distribution of income and wealth. The gain from high income taxes or steep death

⁴ Commission on Social Justice/Institute for Public Policy Research, *Social Justice. Strategies for National Renewal* (London, 1994), p. 376.

⁵ Central Statistical Office, 'The Incidence of Taxes and Social Service Benefits in 1968', *Economic Trends*, 196 (February 1970), p. xvii.

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duties has not been solely or primarily for the revenue they have raised, but mainly for taking away from the rich income and wealth that is offensive. The second argument has been about fairness, which has been used to deflect attention away from levels of tax: 'The real issue is not high versus low tax, as the right tries to claim, but fair rather than unfair tax.'⁶ A fair tax system should not only treat people with different levels of income equally, but it should also deal fairly with those whose income comes from different sources. It should not provide opportunities for people to avoid their proper tax burdens without breaking the law. Paying taxes becomes a moral duty.

These two approaches have certain differences. The first relies upon the power of the state to identify and extract revenue from inevitably resistant taxpayers (those enjoying inherited wealth and high incomes, for example). It is adversarial. The second rests upon a moral agreement that taxes ought to be paid as a necessary service to the community, and therefore to seek reduction of personal taxes to the limit of the law was unethical. It is less class based than the first in its logic. The two aims, however, have often seemed similar. When it is assumed that the better-off are largely to blame for the avoidance of taxes, achieving a fairer tax system and pursuing equality seem to be the same thing, and to require a common vigilance by the tax authorities. But they are different, and as the party's tax experts pursued greater 'fairness' in the 1960s, for example, so an agenda of equality was still waiting to be fulfilled.

The superimposition of one tax strategy upon another has certainly caused the party problems, but it has also seemed to face an uphill struggle in the tasks it has set itself. Some of its favoured schemes have never reached the statute book, such as the capital levy, while others which ought to have served Labour's purpose, including surtax and capital taxes, have been disappointing in their yields. A flavour of the intense activity involved with tax avoidance, and the problems it caused the revenue authorities, can be gained from comments by one tax expert, Arthur Cockfield, on the difficulties which would have faced the implementation of an expenditure tax in the 1950s (a tax never proceeded with):

Legal avoidance would be a more serious problem with an Expenditure Tax than it is with the existing Surtax. The creation of an entirely new and untried basis of charge would open up a completely fresh field of evasion devices and it must be accepted that the lawyers and accountants who specialise in these matters would make the most of their opportunities. It would be many years

⁶ Peter Mandelson and Roger Liddle, *The Blair Revolution. Can New Labour Deliver?* (London, 1996), p. 23.

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before the administration caught up with them and it would involve a formidable mass of legislation.⁷

One difficulty was that legal arrangements that had perfectly legitimate functions, such as trusts and small companies, could also be used as instruments for tax avoidance. The manifesto of 'New Labour' summed up a good deal of the party's experience when it noted that 'tax reliefs for seemingly good purposes can easily become tax loopholes that are exploited by the accountants of the rich and privileged'.⁸

The fact that taxpayers proved to be tireless and endlessly inventive in avoiding tax should not hide the fact that the tide of moral opinion ran in Labour's favour for much of the century. That is, the desirability of progressive taxes went largely unchallenged at the level of political debate. This might be explained by the fact that, until the mid-1960s, the impact of all taxes was not progressive at all, because the effects of a progressive income tax were more than offset by regressive indirect taxes and national insurance contributions.⁹ However, this would be far from the mark. Taxes were rarely discussed in their overall impact, and attention focused far more on personal direct taxation, where progressivity was clear. The concept of progressivity lay at the heart of conventional wisdom about tax. In the early years of the century, the assumption that the marginal utility of income declined at a faster rate than income rose supported an interpretation of equal sacrifice by taxpayers, which meant that the higher up the income scale the disproportionately heavier the tax burden.¹⁰ These beliefs were questioned during later years, so that the supporting assumptions of a clear connection between income and satisfaction which could be common to all, and that utility declined more than proportionately with income's rise, received less assent. But even without its scientific props, the progressive idea in taxation remained remarkably solid. When that ferocious liberal critic of conventional wisdom, F. A. Hayek, challenged the virtue of progressive taxation, he noted that 'In many ways I wish I could omit this chapter. Its argument is directed against beliefs so widely held that it is bound to offend many . . . Redistribution by progressive taxation has come to be almost universally accepted as just.'¹¹

⁷ University College, London, Gaitskell Papers, C. 100.9, 'The Administration of an Expenditure Tax', 30 March 1955.

⁸ Mandelson and Liddle, *The Blair Revolution*, p. 131.

⁹ J. A. Kay and M. A. King, *The British Tax System* (Oxford, 5th edn, 1990), p. 196.

¹⁰ For a discussion of equity issues, see A. R. Prest and N. A. Barr, *Public Finance in Theory and Practice* (London, 1985 edn), esp. pp. 95–7. See also F. Shehab, *Progressive Taxation. A Study of the Development of the Progressive Principle in Income Tax* (Oxford, 1953), p. 209.

¹¹ F. A. Hayek, *The Constitution of Liberty* (London, 1993 edn), p. 306.

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At the time of Hayek's book (1960), the main challenge to progressive taxation was not at the moral level but concerned its impact on incentives to work. In other words, it was for its practical impact upon the economy that it was criticized, which, however much it was dressed up, was essentially an empirical question. Academic and social survey research did not find much substance in the view that a high marginal rate of income tax damaged incentives. It was only in the post-1979 period that an ethical judgement was made. In his memoirs Nigel Lawson reported his exasperation at yet another piece of research which suggested that reducing marginal tax rates did not encourage people to work harder, and noted that 'the case for low taxation is first and foremost a moral one. It is the case for enlarging individual freedom of choice and keeping to a necessary minimum the area where decisions are taken for people by the state.'¹²

Where did tax debate take place, if not at the level of the fundamental moral issues that surround it? The main political challenge to Labour came from the particular interests that its taxes affected. When Labour put forward tax reforms it found itself confronted by an array of interests provoked by its intentions. Companies affected by profits taxes, unit trusts apparently disadvantaged by capital gains tax, or small businesses complaining about death duties, are all examples of this. Such interests inevitably operated upon a rather narrow interpretation of tax debate. They were concerned with specific levels of taxes or particular provisions; the larger nature of the tax system was accepted as given.¹³ Indeed, it was often felt that the detailed revisions being demanded stood a better chance of success if the overall balance of the tax structure went undisturbed. Tax politics quickly descended to the details of particular measures. It therefore drew upon quite specific talents among politicians, because it required an expertise and interest which seemed far away from the bigger questions that taxes ought to have generated. Yet this quite narrow focus did, in the end, return its participants to the

¹² Nigel Lawson, *The View from No. 11. Memoirs of a Tory Radical* (London, 1993, pbk edn), pp. 692–3.

¹³ An example comes from the Confederation of British Industry's tax panel reporting on value added tax: 'Any broadening of the tax base, whether by a VAT or not, would have an effect on income distribution and could place new burdens on the lower income groups. These would require to be compensated by other adjustments to taxation or benefits if the present balance between progressivity and regressivity in the tax system as a whole was not to be disturbed.' The CBI's economic directorate were aware of arguments which precisely challenged the idea of progressivity, of the sort found in Walter J. Blum and Harry Kalven Jr, *The Uneasy Case for Progressive Taxation* (Chicago, 1953). University of Warwick Modern Records Centre (MRC), CBI archive, MSS. 200, C/1/1/ E 406.68, meeting of the taxation panel, 17 November 1968. The CBI was constantly aware of the need to tailor its proposals to the prevailing political climate of the time.

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bigger issues of ideology that often lay at the point of origin of such tax strategies. It is a theme of chapter 5, for example, that it was only when capital transfer tax had to deal with the issue of small businesses that the price of the party's more general egalitarian strategy was uncovered.

The argument is that the party's general propositions about taxes went largely unchallenged and unexamined in the political debate. This had two consequences. First, it meant that the party's strategy was rather poorly focused and led to a lack of clarity about aims. Secondly, it meant that big issues were only engaged as the outcome of what was for the most part an argument about the details of particular taxes. The party therefore confronted its use of taxes only in an oblique and imperfect way. The consequences of this state of affairs can be illustrated by two of the strands which run through the analysis in the main body of this book. The first emerged after 1945 and was to do with reforming the tax system. Led by Nicholas Kaldor's intense, but rather narrowly directed, expertise, the party followed a road towards the comprehensive taxation of various kinds of rewards, which were sometimes income and sometimes capital. The purpose of this was to make the tax system fairer, by establishing a wider concept of taxable capacity and economic power than merely the definitions of earnings as income used by the tax authorities. At the same time, the social democratic leadership of the party was applying taxation to the pursuit of equality to replace nationalization as its core purpose. But the unity of the project began to crumble. The pursuit of a more comprehensive tax system demanded unanticipated amounts of administrative and political energy, yet was not delivering the greater equality which the party expected. As further attempts were made through taxes to meet egalitarian expectations, the vigorous treatment of property that this required was revealed by the problem of how to protect legitimate small businesses from the rigours of the capital transfer tax yet prevent concessions turning into tax-avoidance opportunities. Many in the labour movement not specifically interested in taxes had turned to taxation in a largely unexamined way as an instrument for achieving their aims. Yet it was only when their proposals intersected with particular interests that the difficulties inherent in the strategy became apparent.

Taxation has been a minefield that the major political parties have had to cross. It has involved general political and ethical principles and masses of technical detail. Throughout its history Labour has attached great importance to tax because it provides a practical dimension to so much of what it wants to achieve. Yet commitment to it tends to involve only a small section of the party at any one time, because of its technical, and often tedious, nature. Only a handful of MPs usually appreciate the

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difficulties of taxes carrying this ideological weight. Hence, some of the problems of taxes fulfilling aspirations to fairness or equality only tend to add to the wider sense of frustration that the party is not achieving its proper aims because the complex questions at issue have not been fully appreciated. We might therefore anticipate that tax policy has been a fundamental yet problematic feature of Labour's history.

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1 Struggles within a liberal inheritance, 1906–1940

Although Labour only held office for two short periods down to 1931 its experience goes to the heart of the key themes of this book about the role of a party within the area of taxation. In particular, it explores the question of how far Labour was able to establish its legitimacy as a reforming party within two contexts for tax politics. One of these was presenting tax ideas to the people, where reforms had to be defended against popular instincts and prejudices, especially at election time. The other was arguing a case within the political institutions of the democracy, in royal commissions and in parliamentary committees, for example, which had a wholly different, and rather more academic, flavour than the popular domain. This period therefore establishes some early truths about the nature of tax politics and Labour's involvement in it.

Labour faced these demanding tests in what were two strongly contrasting periods. Before 1914 it had to establish itself within the Liberals' programme of reform and it had to make sure it was not a mere spectator of this reforming energy. After 1918 it had to adapt that inheritance to the much less promising conditions of the 1920s. Reform was no longer carrying all before it and the Conservatives were able to use an anti-socialist appeal which fed off the anxieties towards the modern tax state developed by the war. Although the Liberal Party had been displaced, Liberals interested in public finance were still able to watch their usurpers with a disdainful and critical eye.

Although Labour faced an uphill struggle, its own perspective and character changed considerably in these years. By the inter-war period Labour was no longer a trade union pressure group but a governing party, no longer proletarian but with a strong middle-class element. Ambitions developing in the 1920s had a different and more confident trajectory from those of the founding fathers. This chapter explores some of the contrasts and connections within this theme as it involves the party's tax policy, and in so doing pays particular attention to two individuals, Philip Snowden and Hugh Dalton. For Snowden,

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establishing the independence of the party and winning acceptance for it were the fundamental aims, and the project seemed to end in failure and rancour. While progress was made within the reassuring milieu of pre-1914 liberalism as it was driven by the confident radicalism of Lloyd George, by the 1930s there seemed to have been disengagement, as the pressure of government and budgetary crisis suggested a tension between radicalism and credibility which Snowden was both unable and apparently unwilling to resolve. Finance, from being an arena in which Labour could prove itself, had become one which tore it apart, and the demon of the ‘iron chancellor’, which was to constitute a problematic strand in Labour’s governing performance, was born. Snowden’s career therefore embraces both the promise and the limitations of the liberal inheritance in which he and the party had to operate, and the destructive tensions which this could unleash upon the party in time of crisis.

Dalton offers a very different set of expectations and possibilities. While for Snowden the party was to be both nurtured and ultimately scorned, for Dalton it carried the expectation that power would be achieved and enjoyed. If for Snowden office was precarious and the party often its own worst enemy, for Dalton time was on Labour’s side as brains and talent carried Labour forward to power and reform. Finance was central to both their activities. It was a powerful instrument of government both for raising money and shaping society, and so was a clear indicator of the party’s intentions; it was also a test of capacity, because it was an intricate area of administration with its own special expertise and one where reform could easily be exposed as naive and inept. For much of his career Snowden was the figure through whom the party sought to establish its radicalism and convey its competence in finance to the wider political world, and towards the end Snowden found it impossible to be both a credible chancellor and an authentic representative of his party. Dalton’s position was different. Like others in the 1920s he saw professional expertise, in his case in economics, as a means of advancement within the party. He had a legitimate reputation in public finance and played a substantial part in the party’s tax activities in the 1920s. In the 1930s he played a central role in the policy discussions which followed the débâcle of 1931. Dalton acted as a bridge between Snowden and the success of the 1945–51 government. He maintained an interest in tax and redistribution when these might have seemed outdated and he brought new talent to the party when it was badly needed.

But what exactly was the difference between the two? Did Dalton’s expertise mark a significant advance upon Snowden’s perspective on tax in the 1920s? How far had the party gained ground when war broke out

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in 1940, from its earlier positions? Here, as in the 1920s, the relationship with Liberals is instructive, and damaging.

Labour and Liberals before 1914

The significance of taxation for the party in the pre-1914 period was set out at a conference in 1909 on ‘The Incidence of Taxation’, chaired by Snowden. Ramsay MacDonald explained that Labour was an independent party, ‘not the wing of another party. When the Labour Party followed another Party it followed it as an independent factor.’¹ Labour needed to show that it had a coherent financial policy which conformed to its ideology and could sustain the government expenditures required by the rest of its programme. Snowden had set the tax debate in terms of the challenge of tariff reform as a means for the propertied classes to place heavier burdens on working-class consumption rather than shoulder the cost of social reform themselves. The working classes already contributed more than they should to state finances through indirect taxes, which in amount nearly matched the yield of the income and property taxes and death duties. The ‘considerations’ that Labour set out as the basis for ‘democratic finance’ were taxation in proportion to ability to pay and to the protection and benefit conferred on the individual by the state; no taxation upon the means of subsistence; all unearned increment of wealth to be secured for communal benefit; and taxation on unearned incomes ‘should aim deliberately at preventing the retention of great fortunes in private hands’.² The specific proposals adopted were for a super-tax on large incomes, taxation of ‘state conferred monopolies’ (drink), increased death duties and land value taxation. MacDonald summed up the proposals as the ‘fundamental fact of Labour finance – that we wanted to divide the non-producing parasite dependent upon society from the producer and service-giver; and we wanted to direct our attention to the pockets of the person who did nothing and had much, and direct it away from the pockets of the person who might possess nothing but give much service’.³ This was not itself novel; it followed a resolution proposed at the annual conference in 1906 by Bruce Glasier that the party’s tax policy should ‘secure for the community all unearned incomes derived from what is really communal wealth’.⁴

Whatever MacDonald might have said about Labour being an

¹ Labour Party, *Annual Report* (hereafter *LPAR*) 1909, Appendix II, p. 107.

² *Ibid.*, p. 103.

³ *Ibid.*, p. 107.

⁴ *LPAR*, 1906, p. 58.