Just Taxes

The Politics of Taxation in Britain, 1914–1979

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> One of the clearest contrasts between Conservative and Socialist policy is in the field of taxation. Conservatives believe that high taxation discourages enterprise and initiative, and so tends to impoverish the whole nation . . . By contrast, Socialist policy contains little mention of tax reduction and indeed most Socialists welcome high taxation as a means of achieving their aim of universal equality.
>
> Conservative party, *The Campaign Guide 1959: The Unique Political Reference Book* (London, 1959), p. 19

In 1979, the Conservatives returned to power and Margaret Thatcher* became prime minister. Their success in the general election has many explanations, but one important theme was the widespread sentiment that taxes were too high and the public sector too large and unaccountable. The Thatcher government embarked on a campaign to roll back the state, through privatisation and the sale of council houses; it achieved less success in reducing the overall level of fiscal extraction in order to encourage enterprise and initiative. Taxes were 45.9 per cent of gross domestic product (GDP) in 1979, rising to 49.9 per cent in 1984; the figure dropped to 41.4 per cent in 1989, but returned to 46.8 per cent in 1993[1] (see table 1.1 and figure 1.1). Despite the difficulties in *reducing* taxation as a whole, the *structure* of taxation was changed in pursuit of Mrs Thatcher's vision of a dynamic society based on enterprise and incentives. The tax system was remade, with a marked decline in the higher levels of income tax, a shift from direct to indirect taxes and the introduction of tax breaks on personal savings and private welfare provision.

[1] R. Middleton, *Government versus the Market: The Growth of the Public Sector, Economic Management and British Economic Performance, c1890–1979* (Cheltenham, 1996), p. 91, and *The British Economy since 1945: Engaging with the Debate* (Basingstoke, 2000), p. 77.

* Margaret Hilda Thatcher née Roberts (b. 1925) was born in Grantham, where her father was a grocer and local politician. She was educated at Oxford, and was called to the bar in 1954, specialising in tax law. She became an MP in 1959, serving as secretary of state for education and science 1970–4; in opposition, she shadowed the chancellor before becoming leader in 1975 and prime minister from 1979 to 1990. (K. M. Robbins (ed.), *The Blackwell Biographical Dictionary of British Political Life in the Twentieth Century* (Oxford, 1990), pp. 394–8.)

Figure 1.1 Total public expenditure as a percentage of GDP at current market prices, 1900–1993
Source: R. Middleton, *The British Economy since 1945: Engaging with the Debate* (Basingstoke, 2000), p. 77.

Table 1.1 *Total public expenditure as a percentage of GDP at current market prices, 1900–1993*

	Total	Social services	Defence
1900	13.3	2.3	6.0
1913	11.9	3.7	3.1
1937	26.0	10.5	4.9
1948	37.0	17.6	6.3
1951	37.5	14.1	7.6
1955	37.0	13.9	8.0
1960	37.1	15.1	6.3
1964	38.9	16.5	6.1
1968	43.9	20.2	5.6
1973	42.9	21.2	4.8
1979	45.9	23.9	4.7
1984	49.9	27.1	5.4
1989	41.4	23.1	4.2
1993	46.8	28.8	3.8

Source: R. Middleton, *The British Economy since 1945: Engaging with the Debate* (Basingstoke, 2000), p. 77.

Of course, the Thatcher government had its critics who feared that its policies created socially divisive inequality, and a growing sense of exclusion. Indeed, reform of the tax system contributed to the downfall of Mrs Thatcher when she attempted to overhaul local government finance with the abolition of the property rate and the introduction of the community charge or 'poll tax'. This was an attempt to create fiscal responsibility by electors and councillors in local government. Instead of each household paying a property rate on the value of the house, regardless of income and the number of wage-earners, each resident would pay a charge – and hence create a greater sensitivity to spending on local services. This proved a step too far, leading to a breakdown in compliance and contributing to the fall of Mrs Thatcher. Even so, the rating system was reformed for the first time since the abortive attempt to introduce a land tax by Lloyd George* before the First World War.[2] Meanwhile, the Labour party came to realise that the mere mention of taxes was best

[2] For Lloyd George and the land question, see A. Offer, *Property and Politics, 1870–1914: Landownership, Law, Ideology and Urban Development in England* (Cambridge, 1981), and on Mrs Thatcher and the community charge or poll tax, D. Butler, A. Adonis and T. Travers, *Failure in British Government: The Politics of the Poll Tax* (Oxford, 1994).

* David Lloyd George (1863–1945) was born in Manchester, the son of a teacher who died in 1864; he was brought up by his mother and uncle, a shoemaker in Caernarfonshire. He became a solicitor in 1884 and was a Liberal MP from 1890 to 1945. He became president of the Board of Trade 1905–8, chancellor of the Exchequer 1908–15, minister

avoided. Its defeat in the election of 1992 may be explained, at least in part, by the proposed budget for a Labour government, which allowed the Conservatives to portray the party as committed to policies of 'tax and spend'.[3] The result was a disinclination to engage in serious debate over the tax system, a fear of the political consequences of giving the impression of wishing to raise taxes.

What has been the outcome? Many British electors appear to want increased spending on education and health, and are in favour of specific forms of government expenditure. At the same time, they oppose government spending in general. In 1970, 92 per cent of respondents to an opinion poll wanted higher or stable spending on pensions and social services – yet 65 per cent wanted taxes to be cut in preference to welfare spending.[4] One response by the Labour government of 1997 was the so-called 'stealth taxes' and a continued reliance on indirect taxes which produce large yields. In 2000, the 'tax revolt' against high prices of fuel suggested that the fiscal system had reached some sort of *impasse*. The Thatcher government had de-legitimised high levels of income tax; now, indirect taxes were leading to resistance. How politicians will respond to this difficult situation, reconciling the need for more spending with hostility to taxes, is a topic for the future – and Gordon Brown's budget of 2002 might indicate a change. The debates should be informed by an understanding of the history of the British fiscal system since the First World War.

One aim of this book is to understand the background to the Thatcher reforms of the fiscal system, and to assess why taxation attracted widespread opprobrium both for its *level* and, perhaps more so, its *form*. These concerns were not simply on the right, from Conservative advocates of free markets and private enterprise. Leading economists on the progressive left were also critical of the fiscal system, especially in the report of the committee on direct taxation chaired by James Meade* and in the

of munitions 1915–16 and prime minister from 1916 to 1922. (*Dictionary of National Biography* (*DNB*), *1941–50*, ed. L. G. Legg and E. T. Williams (London, 1959), pp. 515–29; Robbins (ed.), *Biographical Dictionary*, pp. 270–4.)

3 On the 1992 election, see D. Butler and D. Kavanagh, *The British General Election of 1992* (Basingstoke, 1999), especially pp. 252, 255–6, 268; and I. Crewe and B. Gosschalk (eds.), *Political Communications: The General Election Campaign of 1992* (Cambridge, 1994), especially pp. 188–9.

4 For opinion poll data, see R. Lowe, *The Welfare State in Britain since 1945* (2nd edn, Basingstoke and London, 1999), p. 97, citing P. Taylor-Gooby, *Public Opinion, Ideology and State Welfare* (London, 1985), chapter 2.

* James Edward Meade (1907–94) was educated at Oxford, and was fellow of Hertford College from 1930 to 1937; he moved to the Economic Section of the League of Nations in Geneva from 1938 to 1940. He joined the Economic Section of the Cabinet Office in 1940, and was director in 1946–7. He then returned to academic life, as professor of commerce at the London School of Economics (LSE) to 1957 and professor of political economy at Cambridge to 1968. He served as chairman of the Institute for Fiscal Studies

major study of the British tax system of the late 1970s by John Kay and Mervyn King. These studies suggested that the British fiscal system was incoherent, a mass of conflicting and incompatible principles. 'No one would design such a system on purpose and nobody did. Only a historical explanation of how it came about can be offered as a justification. That is not a justification, but a demonstration of how seemingly individually rational decisions can have absurd effects in aggregate.'[5] What they did not explain was *why* this situation had arisen: to economists in search of consistency, it was the product of irrationality. The aim here is to understand how the British tax system took on the shape it did, through a careful analysis of the politics of the fiscal system. This will involve much more than a simple attempt to understand the roots of the *malaise* of 1979; it will entail an understanding of the changing political, economic and social context of taxation over the period. In many ways, the tax system of 1979 was a palimpsest produced by different ideologies and electoral calculations, changing economic structures and circumstances, as well as military and strategic imperatives. An analysis of taxation should form a strand in the history of twentieth-century Britain, for without it we cannot appreciate the ability of the state to secure revenue for warfare and welfare, or of political parties to create electoral coalitions.

The chronological end point of this book is provided by a desire to understand the origins of Mrs Thatcher's reform of the tax system. The starting point is 1914, when the level of extraction was about to double under the pressure of the First World War – and to stay there until it was again displaced by the Second World War. It would be helpful to summarise the main features of the fiscal constitution at the outbreak of the war, which explain the acceptance of the tax system by 1914 and the relative ease with which a much higher level of extraction was sustained after the war. They also formed the main elements in the carefully articulated and firmly held orthodoxy of the Treasury against which innovation would be judged well into the twentieth century.[6] Above all, the aim of this fiscal constitution was to remove disputes over taxation from the heart of British politics by creating a sense of balance and fairness, a feeling that taxes and spending did not fall more heavily on one group at the expense of another. The vocabulary of social description was based less on class terms of labour versus capital or rich versus poor, than moral categories

from 1975 to 1977. He won the Nobel Prize for economics in 1977. (*Who Was Who*, vol. IX: *1991–5* (London, 1996).)

5 J. A. Kay and M. A. King, *The British Tax System* (Oxford, 1978), pp. 1, 238–41, 246; Institute for Fiscal Studies, *The Structure and Reform of Direct Taxation: Report of a Committee Chaired by Professor J. E. Meade* (London, 1978).

6 See M. J. Daunton, *Trusting Leviathan: The Politics of Taxation in Britain, 1799–1914* (Cambridge, 2001).

of idle versus active wealth, waste versus prudence, spontaneous versus industrious incomes, dissipation versus healthy consumption.

The sense of equity and balance also entailed creating an image of politicians as men of probity and trustworthiness, of moral rectitude and fiscal prudence.[7] This applied not only to ministers but also to the Commons, which should inspect and monitor public spending, subjecting the executive to constant scrutiny. The task of monitoring spending and ensuring that revenue was applied only to the intended purposes rested on a carefully devised set of accounting procedures. Revenue should not be hypothecated, that is ear-marked for particular purposes; all sources of revenue should be paid into a single, consolidated fund. The danger of hypothecation was that spending would always rise to the maximum permissible level of the specified revenue; allocation of a set amount of money from a central fund gave more control. This implied a ban on *virement*, the movement of surplus funds from one budget head to another which would also keep spending up to the highest possible level. Rather, parliament would allocate annual 'votes' of money to each service, and any surplus left under any head would be used to reduce the national debt. It followed that great stress was placed on reducing the national debt. In the early nineteenth century, many radical and Tory critics saw the debt as a danger, imposing a burden on production to benefit idle *rentiers* and a monied elite, subverting the social order. By the late nineteenth century, the debt was almost a source of pride and patriotism as the nation's 'war chest'. Confidence in the integrity and probity of the state meant that loans could easily be secured on favourable terms in times of emergency and national danger.

The administration of taxes should, as far as possible, rest on co-operation with taxpayers, even at the expense of a degree of evasion or avoidance. As far as possible, the income tax was collected 'at source', so that banks paid interest to depositors and farmers rent to landlords net of tax, handing the balance to the tax authorities. Where deduction at source was not possible in the case of income from the profits of trade, taxpayers were incorporated into the administration of the tax system as assessors, collectors and commissioners. Any threat to this pattern was denounced as 'inquisitorial' and 'despotic'. In practice, the relationship between taxpayers and the tax authorities was increasingly mediated by professional advisers, and in particular by accountants who negotiated with the tax officials. When decisions were contested and taken to court

7 P. Harling and P. Mandler, 'From "fiscal-military" state to laissez-faire state, 1760–1850', *Journal of British Studies* 32 (1993), 44–70; P. Langford, 'Politics and manners from Sir Robert Walpole to Sir Robert Peel', *Proceedings of the British Academy* 94, *1996 Lectures and Memoirs* (Oxford, 1997), pp. 118–23.

for a ruling on law, the outcome was a highly specific and fragmented body of case law rather than carefully articulated general rules over issues such as the treatment of depreciation or the definition of tax-exempt charities. However, the tax code was careful to exclude tax breaks to particular trades or interests with the dangers of special pleading and favouritism which would undermine trust in the tax system and the state. Any tax concessions were cast in general terms such as tax relief to life insurance premiums in 1853 or for dependent children in 1909. These concessions could be justified on grounds of high principle, of allowing risk-takers to provide their dependants with security, and to support family responsibilities. Members of Parliament could not seek favours for their constituents or particular trades, for the budget was presented to the Commons in a fully developed form and was passed as a matter of confidence in the government.

Care was taken to create a link between taxation and the franchise in order to ensure that potential beneficiaries did not have the power to vote for higher spending which would benefit them and fall on other taxpayers. Until 1867, there was a close connection between the franchise and payment of income tax, for the property qualification for the vote and the income tax threshold were closely aligned. The second and third reform acts weakened the link but did not entirely remove it. Many skilled working men were still wary of government expenditure, stressing their independence of state welfare and the need for self-sufficiency; and many unskilled men did not have the vote until the fourth reform act of 1918. Attitudes were changing in the 1890s and 1900s, with the Trades Union Congress (TUC) and Labour party pressing for a more active, redistributive form of taxation and government action, but the link between the franchise and taxation was not fully severed until after the First World War.[8]

Although the political culture of free trade was dominant by 1860, indirect taxes remained of great importance – on condition that the duties were designed to produce revenue and not to provide protection of home producers or any distortion in the allocation of resources. As a result, customs and excise duties were imposed on a narrow range of goods. Further, most of these commodities were defined as non-essentials or even as harmful narcotics; the payment of indirect taxes was therefore seen as voluntary. The campaign for imperial preference, which would

[8] P. Thane, 'The working class and state "welfare" in Britain, 1880–1914', *Historical Journal* 27 (1984), 877–90; H. C. G. Matthew, R. I. McKibbin and J. A. Kay, 'The franchise factor in the rise of Labour', *English Historical Review* 91 (1976), 733–52; A. E. P. Duffy, 'New unionism in Britain, 1889–90: a reappraisal', *Economic History Review* 2nd ser. 14 (1961), 306–19.

provide protection for British producers as well as a source of revenue, was defeated by the Liberal victory of 1906, and the trend to a higher proportion of direct taxes was confirmed by the subsequent reform of the income tax and the demands of the First World War.

The overall level of taxation as a percentage of the GDP fell up to the close of the nineteenth century. Spending was controlled by these accounting practices, by the identity between voting and paying income tax and by the narrow range of indirect taxes. Further, pressure for spending was limited by four factors. First, economic growth from the 1840s meant an increase in revenue and the possibility of tax concessions. Secondly, part of the cost of defence and imperial expansion was passed from the metropole to the empire. Thirdly, the costs of military spending were relatively modest, for Britain was not involved in any major war and the nature of military strategy and technology meant that there was no need for a massive standing army or navy with continuing investment in research and development. The national debt incurred in past wars was reduced, and there was little or no need to issue new loans except to a modest extent in the Crimean war. Finally, demands for civilian spending were as yet muted, and a large part of spending was undertaken by local authorities rather than the central government. The result of these factors was, in the words of Michael Mann, tax concessions on a world historical scale – and not least in Britain.[9] By the end of the nineteenth century, government spending – local and central – was down to about 9 per cent of gross national product (GNP).

The underlying assumption was that taxes should not alter the shape of society and that they should follow the principle of proportionality, that is extracting more or less the same proportion of total income from everyone. Different taxes might be used to ensure that the system as a whole was balanced. Hence death duties should fall more heavily on personal property than on real property which was also liable to the local rates. Care should be taken not to graduate the income tax and provide the opportunity for socialistic attacks on the rich. It was essential that everyone pay some taxes to make them politically responsible and to contribute to society.

The overall result of the Victorian or Gladstonian fiscal constitution was to create a sense of trust and legitimacy in taxes and the state. But from the 1890s, various cracks started to appear in the edifice, leading to a debate on the future shape of the fiscal system up to the First World War. An extension of the franchise and a gradual change in the assumptions of the organised working class created pressures for change. After the wave

[9] M. Mann, *The Sources of Social Power*, vol. II: *The Rise of Classes and Nation States, 1750–1914* (Cambridge, 1993).

of so-called 'new unionism' around 1890, and the growing influence of unskilled unions within the TUC, attitudes moved in favour of a more active redistributive role for the state and taxation.[10] In part, this represented the successful containment of the state, the purging of interest and the creation of trust and legitimacy. Although the rhetoric may be seen as a means of justifying the *status quo* and containing radical challenge by presenting an image of fairness and disinterestedness, it was more than a mere imposition of a hegemonic discourse. The constraints went both ways, for politicians could not expose their rhetoric as a mere sham; to some extent they had to observe it and to *act* in a disinterested way. And it meant that organised workers in unions and the fledging Labour party could hope to work through the state and a fiscal system they perceived as fair or, at least, capable of reform by parliamentary action. From 1906, and especially 1910 when the Liberal government was more dependent on their support in the Commons, Labour MPs inserted a new, more redistributive note into fiscal debates.

The point may be extended to a more general pressure for 'civilian' spending. This is not the place to repeat the history of welfare spending and the emergence of social policy at the heart of 'high politics'.[11] We might note, however, that the existing institutional form of the British state and of civil society gave a greater role to central government taxation than in many other countries.[12] In the United States, for example, the involvement of the central state in welfare spending on civil war pensions led to suspicion of 'patronage democracy', the use of benefits to obtain votes and to benefit sectional interests. Welfare spending by the federal state meant favouritism and waste rather than efficiency.[13] Further, the emergence of large-scale firms and hostility to trade unions in the United States were associated with the growth of strong internal management hierarchies and, in some cases, the provision of welfare by employers. By comparison with Britain, trade union and friendly society welfare schemes were weak. In Britain, spending by the central state did not cause such concern on the part of many employers and unions. Although employers were divided, with some opposition to state welfare on the grounds that it would increase costs, others actively campaigned for state provision. Many industrial concerns were small, with weak internal management hierarchies and simply lacked the capacity to provide welfare.

[10] Duffy, 'New unionism'.

[11] J. Harris, 'The transition to high politics in English social policy, 1889–1914', in M. Bentley and J. Stevenson (eds.), *High and Low Politics in Modern Britain* (Oxford, 1983), pp. 58–79.

[12] M. J. Daunton, 'Payment and participation: welfare and state formation in Britain, 1900–51', *Past and Present* 150 (1996), 169–216.

[13] T. Skocpol, *Protecting Soldiers and Mothers: The Political Origins of Social Policy in the United States* (Cambridge, Mass., 1992).

Even if they opposed state action, as in the Lancashire cotton industry, their case was weakened by the absence of any alternative provision by employers.[14]

Capacity *did* exist in two places. One was local government, through the poor law, school boards and municipalities. Local expenditure increased more rapidly than central government spending in the later nineteenth century: the annual average real rate of growth in central government spending was 1.5 per cent between 1850 and 1890, compared with 2.9 per cent in local spending.[15] It was preferred by many politicians as a means of delegating responsibility to the localities. This would displace any conflicts and controversy from the central government, and would rely on responsible action by local elites who were accountable to ratepayers. Problems were emerging by 1900, for the local rate base was inflexible and regressive, and was creating tensions with implications for national politics.[16] One trend after 1906 was a move from local to central government initiatives, for central taxes were more buoyant and spending was more easily controlled by the Treasury. The situation in other countries was different. In Germany, for example, the localities and states had access to more revenue from local income taxes than did the Reich. Although local authorities in Britain continued to provide many welfare services, the central government also turned to a second group of institutions. Unions and friendly societies were given a major role as 'approved societies' in administering national insurance with a (modest) state contribution. This incorporation of self-help institutions into the state soon led to pressure from Labour to go a stage further. The problem with contributory insurance schemes was that they were regressive, with a flat-rate contribution and limited redistribution from rich to poor. Rather than pressing for a continuation of nominally democratic self-help provision, Labour realised that the state used its small contribution to control approved societies, and instead argued for tax-funded state welfare. By comparison, German workers were more likely to fear state involvement given the anti-union inspiration of Bismarck's insurance scheme.[17]

At the same time, pressure for military spending increased. Of course, civilian and military spending were related, for one prerequisite of a strong

[14] R. Hay, 'Employers and social policy in Britain: the evolution of welfare legislation, 1905–14', *Social History* 4 (1977), 435–55; H. F. Gospel, *Markets, Firms and the Management of Labour in Modern Britain* (Cambridge, 1992).

[15] Middleton, *Government versus the Market*, table 3.1, p. 90.

[16] J. Bulpitt, *Territory and Power in the United Kingdom: An Interpretation* (Manchester, 1983).

[17] Daunton, 'Payment and participation', 177–9; E. P. Hennock, *British Social Reform and German Precedents: The Case of Social Insurance, 1880–1914* (Oxford, 1987).

military state was a fit British population or 'imperial race'.[18] Welfare spending was therefore needed to create healthy towns and fit bodies. In addition, the nature of military strategy and technology started to change, most especially with the naval race. The outbreak of war in South Africa, with popular support for imperialism and a more powerful military presence in the formulation of policy, placed new strains on the existing tax system. The change in policy and in technology also entailed a close link between science and war, marking a move from the belief that science should contribute to peace and a new awareness that it provided the basis for a 'warfare' state. At the same time, the politics of empire were starting to change, making it more difficult to pass costs to the periphery, and especially India, where consent was more problematical.[19]

Tariff reform and imperial preference offered one response to the mounting pressure on the fiscal constitution. The policy was advocated as a way of raising more revenue from import duties, as well as solving social problems through steady employment at high wages in a protected market, and binding colonies and metropole in economic interdependence.[20] Liberals (and Labour) needed to find an alternative fiscal strategy of free trade, with the implication that the solution was to reform the income tax and create a more progressive fiscal regime. This electoral calculation was linked with a major change in what may be termed the political culture of taxation, a shift away from proportionality to taxation by ability. At one end of the spectrum, this implied a sweeping redistribution of income and wealth and a drive for equality. In the opinion of many members of the Labour party, free trade was desirable on condition that it was linked with a prosperous domestic economy based on high wages, rather than with an impoverished workforce incapable of buying goods and instead producing cheap goods for export markets.[21] A commitment to free trade could therefore have a radical, redistributive edge. It might also imply an attack on 'socially created wealth', whether an increase in the value of land or industrial profits created by the exertions of society as a whole.

[18] There is a large literature, starting with B. Semmel, *Imperialism and Social Reform: English Social-Imperial Thought, 1895–1914* (London, 1960).

[19] H. C. G. Matthew, *The Liberal Imperialists: The Ideas and Politics of a Post-Gladstonian Elite* (Oxford, 1973); D. Edgerton, *England and the Aeroplane: An Essay on a Militant and Technological Nation* (Basingstoke, 1991); F. Turner, *Contesting Cultural Authority: Essays in Victorian Intellectual Life* (Cambridge, 1993), chapter 8; C. Dewey, 'The end of the imperialism of free trade: the eclipse of the Lancashire lobby and the concession of fiscal autonomy to India', in C. Dewey and A. G. Hopkins (eds.), *The Imperial Impact: Studies in the Economic History of Africa and India* (London, 1978), pp. 35–67.

[20] E. H. H. Green, 'Radical conservatism: the electoral genesis of tariff reform', *Historical Journal* 28 (1985), 677–92.

[21] F. Trentmann, 'Wealth versus welfare: the British left between free trade and national political economy before the First World War', *Historical Research* 70 (1997), 70–98.

But it was not necessary to move in these potentially radical or socialist directions, which might alienate property owners and the middle class from the Liberals. A degree of redistribution could be justified on other, more conservative or prudential, grounds. Officials at the Treasury and Inland Revenue came to realise that the only way to extract more revenue would be through a degree of progression. The existing income tax was based on a single rate, with degression for smaller incomes through abatements – a tax-free allowance. As a result, modest middle-class incomes just above the abatement threshold paid a high marginal rate, and any increase in the standard rate would hit them. The only way to raise more revenue from the income tax without alienating a large part of the electorate was through an additional surtax on larger incomes, and even a *reduction* in modest middle-class incomes with family responsibilities. Such a change in policy towards a graduated, progressive income tax was justified by leading figures in neo-classical economics. The 'context of refutation' had changed, so that the onus rested on opponents of redistribution to indicate that it would harm freedom and efficiency.[22]

The present book starts at this point, after the Liberal reforms of the tax system and the introduction of differentiation, graduation and children's allowances. The First World War put this fiscal system under huge strains, on a scale unknown since the Napoleonic wars. But in many ways the British state was better placed to respond to the challenges of war than other European states. The success of the British state in creating a high level of consent and legitimacy, and in reforming the tax system by 1914, meant that the British state entered the war with a more effective fiscal system than most other combatants. In Germany, a national income tax was only introduced in 1913, and in France in 1914 without producing much revenue. At the end of the war, taxation in most European countries was a source of considerable difficulty, not least because of the issue of how to pay the national debt.[23] Indeed, in the opinion of Joseph Schumpeter, the economist and finance minister of Austria at the end of

[22] See the discussion in Daunton, *Trusting Leviathan*, chs. 6 and 11. For the views of the leading neo-classical economist, Alfred Marshall, see J. K. Whitaker (ed.), *The Correspondence of Alfred Marshall, Economist*, vol. III: *Towards the Close, 1903–1924* (Cambridge, 1996), pp. 231–4; and A. C. Pigou (ed.), *Memorials of Alfred Marshall* (London, 1925), pp. 443–4. The notion of the 'context of refutation' is from S. Collini, *Liberalism and Sociology: L. T. Hobhouse and Political Argument in England, 1880–1914* (Cambridge, 1979), p. 9.

[23] N. Ferguson, 'Public finance and national security: the domestic origins of the First World War revisited', *Past and Present* 142 (1994), 141–68; J. M. Hobson, 'The military-extraction gap and the wary Titan: the fiscal-sociology of British defence policy, 1870–1913', *Journal of European Economic History* 22 (1993), 461–506; C. Maier, *Recasting Bourgeois Europe: Stabilization in France, Germany and Italy after World War I* (Princeton, 1975).

the war, the outcome was a 'crisis of the tax state'.[24] In Britain, the level of fiscal extraction did not drop after the First World War – and neither was there a serious loss of consent or legitimacy. What stands out is the weakness of such a crisis, or more accurately its successful resolution. This contrasts with the serious tensions in Britain after the Napoleonic wars and in other European countries after the First World War – and the outcome had significant long-term consequences. The explanation is to be found, in part, in the very success of the process of stabilisation in the nineteenth century, the way that taxation and the state were accepted as 'fair' and 'neutral'. Politicians and officials prided themselves on their ability to maintain financial stability and political legitimacy in comparison with their counterparts in Europe, and the British fiscal constitution was held up as a source of national pride and achievement. This may be read as a culmination of the Victorian or Gladstonian fiscal constitution of balance, neutrality and fairness. The rhetoric constrained politicians – and it could also free the left to make use of taxation and the state.

The consequences were significant. In the medium term, an increase in the level of taxation permitted higher levels of spending on welfare, which in turn helped to moderate the economic and social impact of the world depression of the early 1930s. The successful resolution of the problem of the 'floating debt' after the First World War contributed to financial stability in Britain – a point deserving of more attention than it usually receives compared with the intense controversy over the gold standard.[25] The ability to keep central government taxes at a high level also affected the form of the state and of welfare, contributing to the shift from local to central funding and initiatives, and to the growth of tax-funded compared with contributory welfare.[26] And the need to maintain consent to taxation should be inserted into debates over appeasement in the 1930s. When taxation was already so high, could more money be found for rearmament?[27] The possibility of resistance from taxpayers might be counter-productive, merely suggesting that Britain lacked the capacity or willingness for war.

In the longer term, the consequences start to become more problematic. The Second World War marked a further displacement in fiscal

[24] J. Schumpeter, 'The crisis of the tax state', in A. Peacock, R. Turvey, W. F. Stolper and E. Henderson (eds.), *International Economic Papers IV* (London and New York, 1954), pp. 5–38.

[25] See S. Solomou, *Themes in Macroeconomic History: The UK Economy, 1919–1939* (Cambridge, 1996).

[26] Daunton, 'Payment and participation'; for another view, on the Treasury desire to shift to contributions, see J. Macnicol, *The Politics of Retirement in Britain, 1878–1948* (Cambridge, 1998).

[27] See G. C. Peden, *British Rearmament and the Treasury, 1932–39* (Edinburgh, 1979).

Figure 1.2 Standard rate of income tax, 1900–1980 (percentage)
Source: B. R. Mitchell, *British Historical Statistics* (Cambridge, 1988), p. 645.

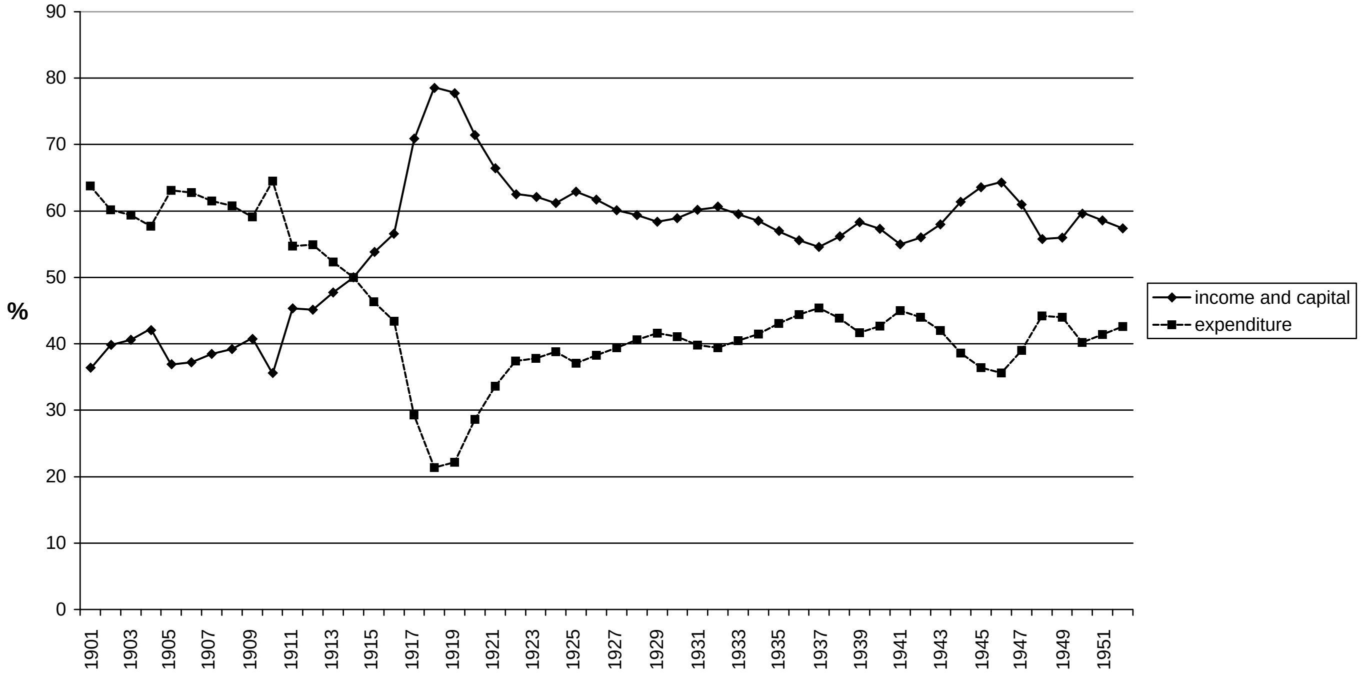

Figure 1.3 Taxes on income and capital (including national insurance contributions) and taxes on expenditure as a percentage of central government receipts, 1900–1951
Source: London and Cambridge Economic Service, *The British Economy: Key Statistics, 1900–70* (London, 1971), p. 112.

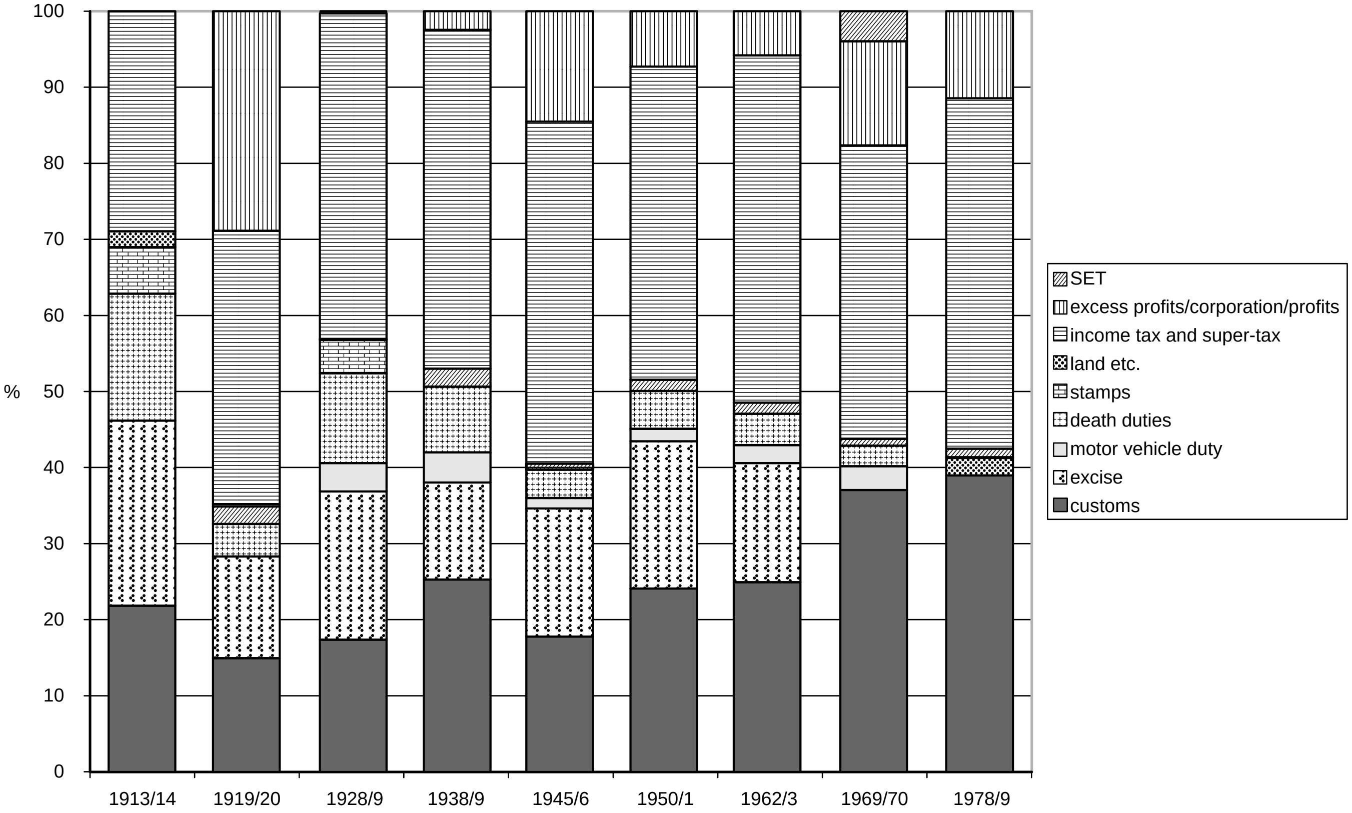

Figure 1.4 Structure of central government revenue: net receipts due to the Exchequer, 1913/14 to 1978/9
Sources: see sources for tables 2.4, 4.3, 5.2, 6.2, 7.2, 8.3 and 10.4.

extraction and a further shift to tax-funded welfare. Levels of taxation were now affecting the distribution of income and leading to a decrease in inequality. Could the result be a loss of incentive and lower levels of growth? Many historians suggest that a consensus emerged during the Second World War, leading to an acceptance of Keynesianism and the welfare state, underwritten by high levels of spending and taxation. However, it is not clear that consensus *was* so powerful.[28] Attitudes to the impact of taxation on incentives and the desirability of equality were highly contested and stood at the heart of British politics from the late 1950s. The appearance of consensus might well arise from the constraints of economic and political circumstances rather than from any ideological convergence. It was one thing to propose competing solutions; it was another thing to act, escaping from short-term management of immediate problems to articulate (and implement) a new strategy. The appearance of consensus in the 1950s might arise, as Rodney Lowe has suggested, from evading rather than addressing problems, whether from a lack of nerve by politicians, or the weaknesses in the machinery of government.[29] The adversarial nature of the two-party system meant that during the period of alternating governments of the 1960s and 1970s policy was incoherent rather than consensual. As a result, the fiscal system which once seemed a source of stability and national pride now seemed a source of inflexibility and a cause of low growth compared with other countries. The British

[28] For consensus, see R. T. Mackenzie, *British Political Parties* (London, 1965), who argues for convergence in practice, despite differences of rhetoric. D. Kavanagh and P. Morris, *Consensus Politics from Attlee to Thatcher* (Oxford, 1989), and D. Kavanagh, *Thatcherism and British Politics: The End of Consensus?* (Oxford, 1987), argue for consensus in the period from 1945 to the 1970s, based on a mixed economy, full employment, the role of unions, the welfare state and foreign and defence policy, which continued beside an adversarial party system until consensus broke down in the 1970s. For a different view of adversarial politics at the expense of consensus, see S. E. Finer, 'Adversary politics and electoral reform', in S. E. Finer (ed.), *Adversary Politics and Electoral Reform* (London, 1975), pp. 3–32, who argues that the divide between two parties gave power to the right and left wings at the expense of the centre ground, so that minor swings in the vote between parties exaggerated shifts in policy. For a more complex view of the connection between adversarial politics and consensus, see A. M. Gamble and S. A. Walkland, *The British Party System and Economic Policy, 1945–83: Studies in Adversary Politics* (Oxford, 1984). They reject the view that adversarial politics simply destroyed continuity of policy; rather, consensus was achieved by excluding major areas from debate at the expense of a ritualised party conflict on a few issues. In their opinion, the failure arose in areas which were *not* in dispute, such as the cross-party agreement that the tax base was too narrow, as well as in areas of bitter dispute. For a more sceptical view of the entire idea of consensus, see B. Pimlott, 'The myth of consensus', in L. M. Smith (ed.), *The Making of Britain: Echoes of Greatness* (London, 1988) pp. 129–41. For an overview of the debate, see D. Kavanagh, 'The postwar consensus', *Twentieth Century British History* 3 (1992), 175–90. These issues are picked up in later chapters.

[29] R. Lowe, 'Resignation at the Treasury: the Social Services Committee and the failure to reform the welfare state', *Journal of Social Policy* 18 (1989), 524.

fiscal constitution was widely criticised for its failings, and officials and politicians looked to other countries for solutions.

The present study is mainly concerned with the formulation of tax policy, and the analysis is consequently heavily dependent on the records of central government, supplemented by discussions within political parties and 'peak' organisations of labour and capital. It views the tax system through the eyes of officials and politicians, how they interpreted public attitudes to taxation and the likely outcome for tax yields and elections. The justification of this approach is in part a matter of priorities, a need to establish the main lines of tax policy over the period. But it also reflects the distinctive nature of tax policy which was shaped by civil servants and between civil servants and politicians to a much greater extent than in the nineteenth century. A major concern of this study is the character of the British state – which is not to say that ideas or non-governmental forces are ignored. The question is: how far did they influence the shaping of policy by the state? What is the relationship between the institutions of the state, and its permeability to ideas and to forces outside the government?[30]

Taxes in Britain were determined in conditions of secrecy, with a strong emphasis on the exclusion of interest groups. The obvious contrast is with the United States, where the president cannot impose a budget on Congress: it is amended in detail on the floor of the House and Senate. During this process, politicians offer support in return for amendments to protect various local or sectional interests, with the result that the tax system is a mass of exemptions and anomalies. Defeat of the budget does not lead to the fall of the government and an election, given fixed terms and the division of responsibilities between legislature and executive. Failure to pass the budget might paralyse the federal executive, but Senators and Representatives are more interested in fighting for the particular needs of their constituents in order to secure campaign funds and re-election. In Britain, the situation is very different. The annual budget is drawn up in conditions of secrecy by the leading officials of the Treasury and revenue departments, in consultation with the chancellor of the Exchequer and his junior ministers. British officials have immense authority compared with their American counterparts who lack such a high level of continuity,

[30] For an explanation of a similar approach to the American fiscal system, stressing an interplay between institutions and ideas or knowledge, see W. E. Brownlee, 'Reflections on the history of taxation', in W. E. Brownlee (ed.), *Funding the Modern American State, 1941–1995: The Rise and Fall of the Era of Easy Finance* (Cambridge, 1996), pp. 3–36, which is aligned with two volumes on the comparative development of the modern state: M. O. Furner and B. Supple (eds.), *The State and Economic Knowledge: The American and British Experience* (Cambridge, 1990), and M. J. Lacey and M. O. Furner (eds.), *The State and Social Investigation in Britain and the United States* (Cambridge, 1993).

both in terms of personal career and identity with a departmental ethos which went back to the creation of the Gladstonian fiscal constitution.[31] British officials could, almost instinctively, block any novel scheme proposed by a chancellor by noting that it contravened the treatment of the national debt laid down in 1829 which had made Britain so prosperous and the cynosure of other nations. It took a brave and well-informed (or an obstinate and ill-informed) chancellor to overrule such advice and to challenge British traditions. Most chancellors held office for a relatively short time and lacked real expertise, so that officials were often dominant. A few exceptional chancellors did overrule the Treasury, insisting that tradition was not sacrosanct, that circumstances could change and that the past was contingent rather than immutable. Winston Churchill* as chancellor between 1924 and 1929 had the time, force of character and politically astute vision to shape the fiscal constitution. Hugh Dalton,† Labour's chancellor after the Second World War, was unusual in having academic expertise in finance, and his knowledge gave him independence of the Treasury. But such men were exceptional.

Officials and ministers might receive deputations or written submissions from the Federation (later Confederation) of British Industries

[31] S. Steinmo, 'Political institutions and tax policy in the United States, Sweden and Britain', *World Politics* 41 (1988–9), 329–72; T. Skocpol, 'Bringing the state back in: strategies of analysis in current research', in P. B. Evans, D. Rueschmeyer and T. Skocpol (eds.), *Bringing the State Back In* (Cambridge, 1985), pp. 1–16; M. O. Furner and B. Supple, 'Ideas, institutions, and state in the United States and Britain: an introduction', in Furner and Supple (eds.), *The State and Economic Knowledge*, pp. 3–39.

* Winston Leonard Spencer Churchill (1874–1965) was educated at Harrow and Sandhurst, joining the army and also working as a war correspondent. He became a Unionist MP in 1900, moving to the Liberals in 1904 in opposition to tariff reform. He became parliamentary under-secretary of the colonies in 1906; he was president of the Board of Trade 1908–10, home secretary 1910–11 and first lord of the Admiralty 1911–15. In 1915 he became chancellor of the Duchy of Lancaster, but resigned to join the army. He returned to office as minister of munitions in 1917–18, secretary of war and air in 1918–21 and colonial secretary in 1921–2. He was out of the Commons from 1922 until 1924, when he returned as a Conservative until 1964. He was chancellor of the Exchequer 1924–9, and split from the party over the India bill in 1931. He was prime minister 1940–5 and 1951–5. (*DNB, 1961–70*, ed. E. T. Williams and C. S. Nicholls (Oxford, 1981), pp. 193–216; Robbins (ed.), *Biographical Dictionary*, pp. 98–102.)

† Edward Hugh John Neale Dalton (1887–1962) was the son of the chaplain to Prince George (later George V); educated at Eton and King's College, Cambridge. He was called to the bar in 1914 and served in the war; he joined the economics department of the LSE after the war and was reader between 1920 and 1936. His *Principles of Public Finance* appeared in 1923 and attempted to draw a distinction between academic neutrality and partisan argument; his other main publication was on equality of incomes. He was a Labour MP between 1924 and 1931 and 1935 and 1959. In the war-time coalition, he was minister of economic warfare 1940–2 and president of the Board of Trade 1942–5; in the postwar Labour government, he was chancellor of the Exchequer 1945–7, chancellor of the Duchy of Lancaster 1948–50 and minister of town and country planning 1950–1. (*DNB, 1961–70*, ed. Williams and Nicholls, pp. 266–9.)

(FBI), the TUC and other associations, but there was not a dialogue. These associations expressed their views and concerns, and would at most receive bland general assurances or statements of principle. The officials and ministers would not share their concerns or hint at any proposals for change in the tax system. Indeed, even the Cabinet often did not discover the main lines of the budget until shortly before it was presented to the House of Commons, when it was usually too late to make any significant changes. The spending departments made their submissions of expenditure and were largely excluded from discussion of how the money should be raised. When the budget was presented to the Commons, there was little room for adjustment. Support of the budget was a matter of 'confidence', and defeat would result in an election. This did happen on a number of occasions in the nineteenth century; it did not happen once after 1914. Party discipline and self-interest meant that few MPs on the government benches would vote against the budget, unlike in the United States where the House or Senate might be controlled by a different party from that of the president. Consequently, there were few opportunities in the British fiscal system for 'log rolling' and tax breaks or exemptions for particular groups; for that matter, neither was there much chance of serious discussion of new proposals.[32]

Such a view suggests that the British state – and especially officials in the Treasury and revenue departments – had considerable autonomy, with a firmly entrenched administrative ethos which was relatively impervious to outside influences. But it might be objected that this account misses the emergence of a more 'corporatist' polity since 1945. Interests were often expressed by organised institutions from the First World War and even more so from the Second World War, culminating in the creation of the National Economic Development Council (NEDC) and the Prices and Incomes Board. On this view, government officials bargained with fellow bureaucrats in large representative institutions, whether the leaders of the National Union of Teachers in education or the British Medical Association in health. As Manzer put it, 'stable relationships usually develop among the interests clustering about a decision-making centre', and the role of the government was largely confined to technical details or marginal adjustments. The outcome, in Mancur Olson's account, was a rigid, inflexible system of 'distributional coalitions' which were difficult to shift. Furthermore, competing administrations were tempted to offer more spending to particular interest groups in a 'bidding war', seeking to purchase support so that spending spiralled upwards and forced the

[32] Steinmo, 'Political institutions and tax policy', and *Taxation and Democracy: Swedish, British, and American Approaches to Financing the Modern State* (New Haven, 1993).