WHY DO FISCAL CONSTITUTIONS CHANGE? British experience since the nineteenth century

Martin Daunton
University of Cambridge

James Buchanan and the Virginia School

James Buchanan drew a distinction between

- limited in-period debates over taxation which were not central to politics

- shifts in the fiscal constitution which were deeply contentious, before the codes and rules of the new parameters are accepted as ‘natural’ and self-evident

CASE STUDIES

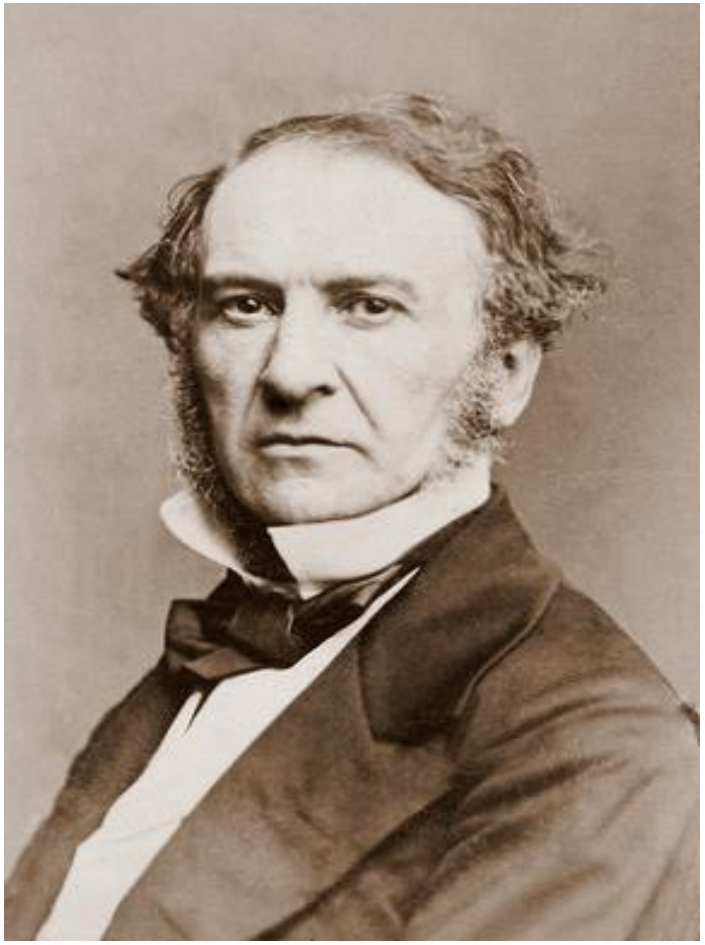
Constitutional change occurred on a number of occasions

- the reintroduction of the income tax in 1842 by Robert Peel and Gladstone's budget of 1853
- Differentiated and progressive income tax between 1906 and 1910 associated with Lloyd George and Winston Churchill
- the changes associated with Margaret Thatcher and Geoffrey Howe after 1979

CURRENT POSITION

- Are we now at a similar point, when a more technical approach to taxation and public finance that had a relatively low public engagement gives way to a much more ideological and public debate.
- Address the question of when and why in-period discussions in the past give way to constitutional change, and what lessons there might be for the present.

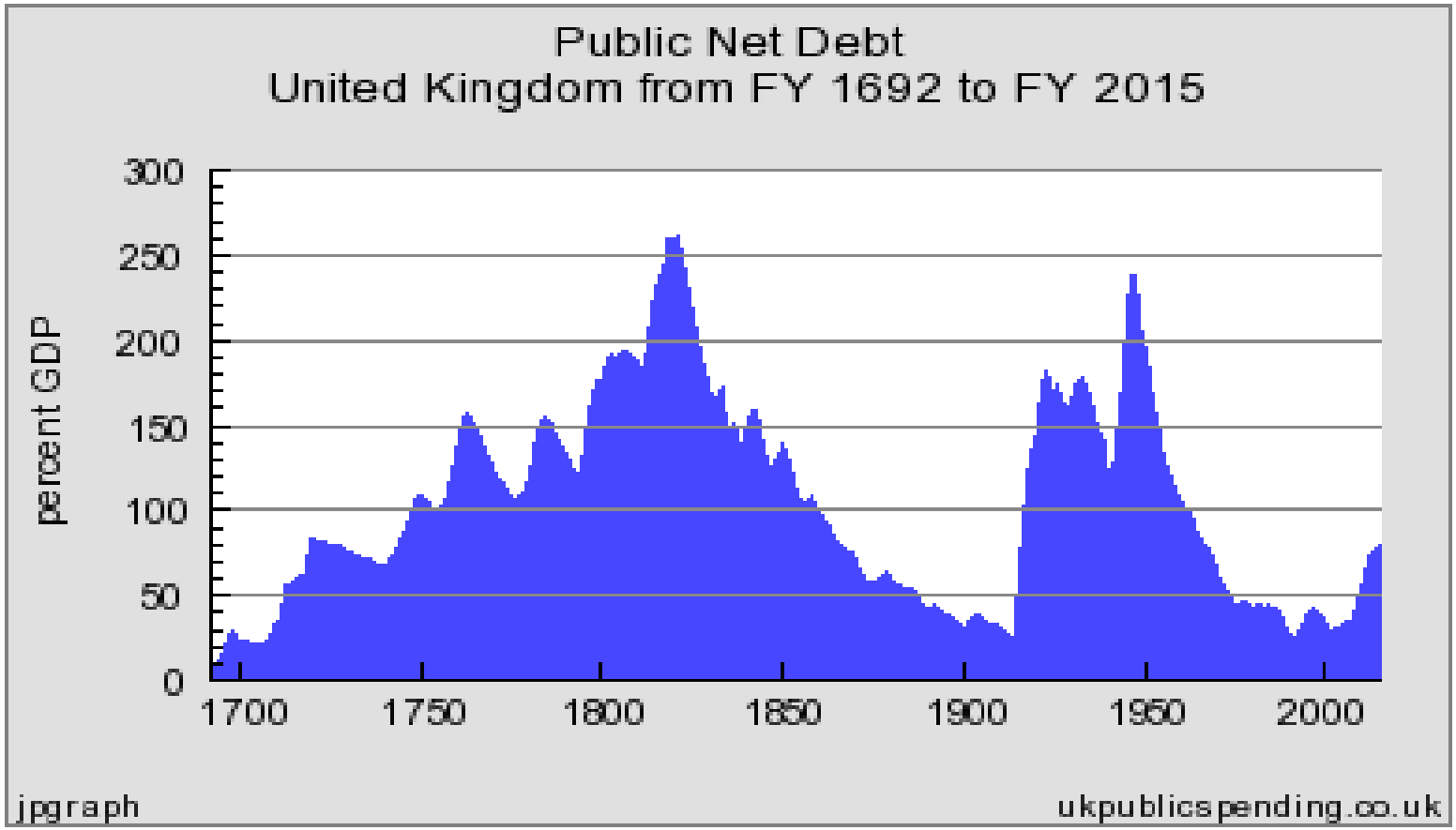
PEEL AND GLADSTONE



THE CRISIS OF THE EARLY NINETEENTH CENTURY

- Defeat of French: removed rationale for high taxes. Public spending 23 per cent of GNP in 1810
- High costs of debt service after war - c55 per cent of central government spending; debt c260 per cent of GDP
- Expiry of income tax in 1816, failure to increase land tax; burden fell on customs and excise duties. Direct taxes fell from 39.8 per cent of central revenues in 1811/15 to 25.2 per cent in 1831/5. Burden on productive classes to pay rentiers
- Unreformed franchise before 1832: Liverpool aimed to show could limit spending in old regime, but merely exposed the problems

NATIONAL DEBT AS PERCENTAGE OF GDP



CREATING LEGITIMACY

- Reduce spending: by 1840 down to 11 per cent of GNP
- Peace dividend – and rapid economic growth
- Pass costs to empire – in turn led to crisis in 1848
- Balance taxes: reduce customs and excise duties, allow poor to share in comforts and enjoyments

PEEL'S IDEOLOGY

- 1830 in cutting excise duties:

"He thought it one of the first duties of the legislature to do all in its power to excite a taste in the humbler classes of society for those comforts and those enjoyments – those luxuries he might add – of civilised society, the desire for which, and the habitual possession of which, would form the best guarantee that the higher classes could have for the possession of their property and their power."

PEEL'S IDEOLOGY

- 1842 justified income tax:

"the country is in that state, that the property of the country must submit to taxation, in order to release industry and the millions from it; that the doing so voluntarily and with a good grace, will be a cheap purchase of future security."

NEUTRALITY AND DISINTERESTEDNESS

- Payment of income tax linked to vote: hence vote for cheap government and not militarism, so convincing Richard Cobden that wise to adopt the tax. Income tax was to constrain the state.
- Ensure range of taxes hit all classes equally, for example, by death duties
- not uses taxes for redistribution and class war: not progressive nor differentiated
- But breaks for life insurance for 'industrious incomes' – available to those who were prudent

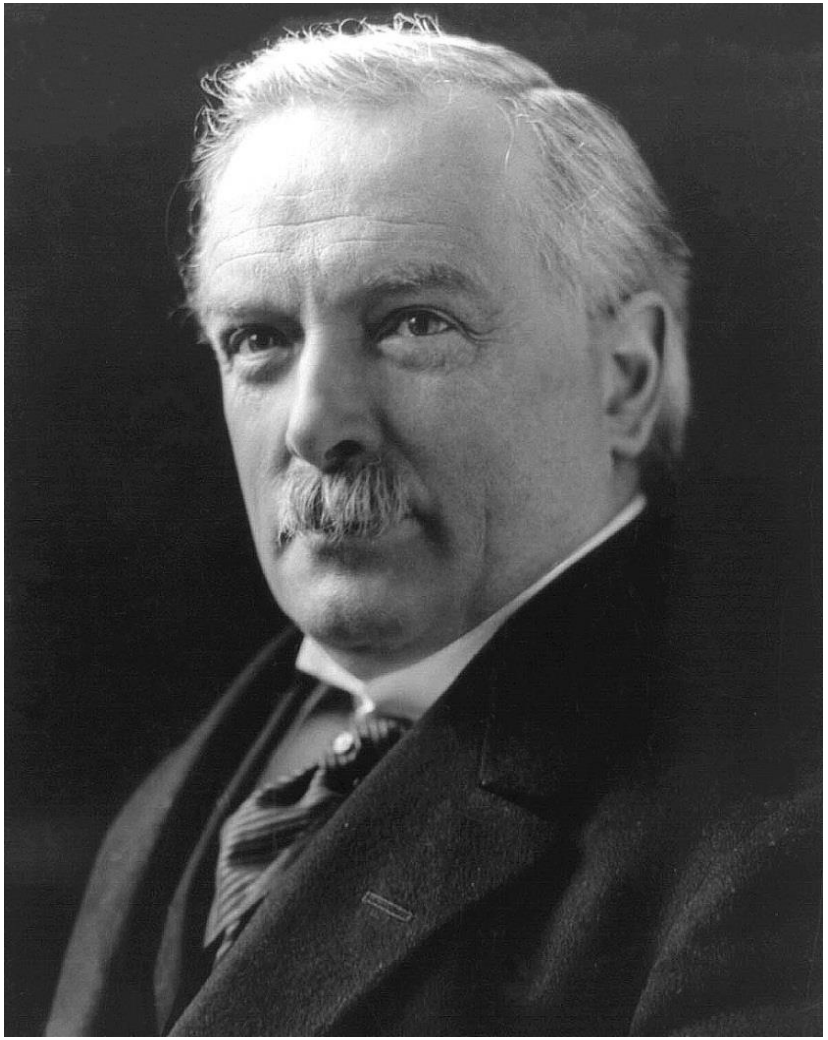
PRINCIPLES OF ADMINISTRATION

- Any surplus only to reduce the debt; Post Office Savings Bank to create private and public prudence.
- Annual votes of parliament so not burden the future; and not *vire* any unspent surplus
- No hypothecation of revenue which would increase spending
- Involve taxpayers in administration so that not intrusive

OUTCOME

- By 1890, total government spending down to 8 per cent of GNP
- Service of national debt down to c25 per cent of central government spending or c40 per cent of GDP
- Direct taxes from 25.2 per cent of central revenues in 1831/5 to 39.7 per cent in 1891/5
- Tax system seen as fair and equitable compared with rest of Europe – BUT about to become subject of political controversy

LLOYD GEORGE and CHURCHILL



FISCAL POLITICS AROUND 1900

- Crisis of local finance:
  - rising costs of new poor law and urban services
  - lack of buoyancy in rates and collapse of property values, strains in compounding
- Emergence of debates over poverty and unemployment: contested solutions
- Costs of warfare – start of naval race (resignation of Gladstone in 1894) and Boer War

CONTESTED SOLUTIONS

- Chamberlain and tariff reform: provide revenue and solve the problem of unemployment
- Lloyd George: free trade led to prosperity; once that was accepted, needed another source – progressive and differentiated income tax
- Needed to clear out the old Gladstonian guard at the Treasury and Inland Revenue, accept marginal revolution
- The land question: the unearned increment was socially created and belonged to the people
- Issue was fought in elections of 1906 and twice in 1910 – Liberal policy was designed to create working class support but alienated middle class. Tension resolved by shift from tax to insurance funding of welfare; and reduced taxation of married men with children so paid less than before

OUTCOMES

- Helped to pay for the war more effectively than in France or Germany
- Government spending to c24 per cent of GDP where it stayed between the wars
- Debt service back to c180 per cent of GDP – but political problems were resolved better than in most other countries, by stressing balance and neutrality of the state
- Winston Churchill continued the pre-War policy in 1925: create electoral support from married men with children, let rich and single pay more. Direct taxes to 64.2 per cent in 1929/30
- Second World War did not lead to a fiscal crisis: rapid economic growth and cheap money reduced debt service
- Basic structure of taxation survived

CRISIS OF FISCAL POLICIES IN THE 1970S

- Shift in taxation/franchise:

  1949 married man with 2 children earned 187 per cent of average earnings before paying standard rate of income tax

  1975, 44.6 per cent
- Median voter now paid income tax – shifted politics. Initial rate was high at low incomes – real issue of high marginal rates was at the lower end, despite marginal rate of 98 per cent on high earned incomes.
- Taxation was complex – and concern over incentives, though Treasury felt marginal rate of 75 or even 65 per cent was justified, but no need to go lower

CULTURAL SHIFTS

- Lower growth rate and demands still increased: from tax to debt state
- Collapse of profits more than in other OECD countries – 4.1 per cent after tax in 1970. Affects post-war settlement.
- Less acceptance that wealth and income generated by society as a whole: age of fractures, more fluid sense of identities. Dan Rodgers: 'solidity and collective institutions replaced by a more individualised sense of human nature based on choice, agency, performance and desire
- Change in political mobilisation – what Geoff Eley calls 'tyranny of structurelessness'
- Was taxation providing service? changed attitudes of affluence
- Choice: not just on right (note shift from Gladstone to PEPs) but left (right to chose)
- Two Santa Claus approach: Democrats offered spending to help the poor; Republicans did not oppose spending, but said that tax cuts would increase employment and so reduce need to spend

OUTCOME

- Not simplification as urged by Meade report of an expenditure tax and progressive annual wealth and accessions tax – utopian
- Top rate of income tax on earned income from 83 per cent to 60 per cent in 1979 and 40 per cent in 1988
- Shift to indirect taxes (VAT raised from 8 to 17.5 per cent) and later stealth taxes, user changes
- Shift in taxes relief on life insurance to PEPs (1987), end of differentiation: encouragement of entrepreneurs' rather than civil servants' assets (IFS)
- Rhetoric of taxation as expropriation of personal wealth/income rather than collective benefits: delegitimises taxation. See recent speech of Cameron: moral to cut taxes so families have more to spend, implying immoral of state to spend.
- Not a major reduction in scale of the state

CONCLUSIONS

- Each shift in constitution had its own particular reasons and contingencies BUT
- Peel and Gladstone were aware that austerity was not enough – equity and fairness, balancing the tax system, showing everyone they shared in prosperity. In fact, merely cutting spending led to MORE political unrest in the first instance.
- In 1842 and 1909/10, governments provided a clear rationale for taxation as fair and reasonable, even if in former case to constrain the state and the other to release constraints.
- Making taxes seem unfair (the Amazon and Starbucks phenomenon) is dangerous in creating hostility as after 1815 – taxes are needed to service the debt and reduce the deficit, which is not so easy as after 1815 (high growth) or after 1945 (high growth and low interest).
- More attention is needed to shape of the tax regime in current political circumstances, as by Peel and Gladstone, and by Lloyd George and Churchill.

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