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The Limits of Social Democracy?

Tax and Spend under Labour, 1974-1979

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Preface

This paper is a revised version of an Economic History thesis submitted to the London School of Economics in September 2000.

The main text assumes analytical rather than chronological form, and, to avoid breaking the flow of the argument, it refers to persons, Labour Party structures and Britain's macro-economy without offering introductions. To avoid assuming knowledge an appendix is added which briefly details the following: chronology; the jobs of individuals mentioned; the levels of inflation and unemployment; and, the structure and purpose of the Labour Party committees cited in the paper. This should be referred to whenever the main text seems presumptuous.

The text also uses a few political and economic abbreviations. These are spelled out on the next page rather than in the body of the main text.

Abbreviations

AES	Alternative Economic Strategy
BIS	Bank of International Settlements
CSO	Central Statistical Office
DHSS	Department of Health and Social Security
GDP	Gross Domestic Product
GGE	General Government Expenditure
GGR	General Government Revenue
HMSO	Her Majesty's Stationery Office
HPC	Home Policy Committee [of Labour's NEC]
IMF	International Monetary Fund
NEB	National Enterprise Board
NEC	National Executive Committee [of the Labour Party]
NEDC	National Economic Development Council
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
OPEC	Organisation of Petroleum Exporting Countries
PSBR	Public Sector Borrowing Requirement
SDP	Social Democratic Party
TGWU	Transport and General Workers' Union
TUC	Trades Union Congress
VAT	Value Added Tax

1: Introduction

Acting mainly through the Budget, although with the aid of other instruments, government can exert any influence it likes on income distribution, and can also determine, within broad limits, the division of total output between consumption, investment, exports and social expenditure.

Tony Crosland, 1956[1]

One of the realisations of the 1970s was that unduly extended states are weak states: their reach exceeds their grasp.

Robert Skidelsky, 1995[2]

During the 1970s free-market views began to prevail over Croslandite optimism about the state's capability. The intellectual rise of the New Right was concurrent with developments in policy. Skidelsky sees 1970s governments worldwide as having been forced into retreat, having reached the limits of their powers. Since the late Nineteenth Century expectations of economic policy's potential had tended to increase. By 1960, it was near consensual that an appropriately activist state could (and should) redistribute, create jobs, provide services and increase productivity. The 'overreach' thesis sees this as having been misplaced. Too much was being asked of government, so it tried to affect too many outcomes while controlling none effectively: expectations of the state needed to diminish and more market outcomes be accepted.

This study looks at the origins of 'rolling back the state' in Britain.

1.1 'Tax-and-Spend' and Social Democracy

In Britain 'social-democratic' sometimes refers to the views of the Labour Right (and, after 1981, the SDP), regardless of intellectual content. But this paper consistently defines 'social democracy' in an historically-specific way – as the doctrines of writers like Crosland and, on the other side of the Atlantic, Galbraith. This social-democratic approach dominated the post-war

[1] Crosland, C. A. R., *The Future of Socialism* (Jonathan Cape, 1956), p. 27.
[2] Skidelsky, R., *The World After Communism* (Papermac, 1995), p. 121.

programmes of progressive Western parties. It aimed, like the Left as a whole, at greater equality. Its distinctiveness lay in the means advanced: Keynesianism and a gradually growing state. The 1970s certainly saw Keynesianism challenged – by floating exchange rates and OPEC-induced 'stagflation'. But the focus here is on the other component: the big state.

Social democracy did not aim towards a state of a specific target size, and certainly not at a totally centralised economy – indeed, an aversion to this end separated it from the Far Left. But in practice the social-democratic programme centred on the state providing steadily more: the belief that the state was unduly extended was thus incompatible with it.

Partly, this 'statism' reflected the presumption that those things that the state increasingly provided – health, education, housing, etc. – were intrinsically especially worthwhile, what economists call 'merit goods'. Galbraith warned the Left against being "co-conspirators with the conservative in reducing taxes", even where they were regressive.[3] Revenues were needed to redress the "bizarre contrast" between the satiation of the often frivolous and artificially generated wants of private consumption and the "poverty which afflicts our public services", making any tax cut a mistake.[4]

But partly, high tax-and-spend was seen as the route to equality. The big state was egalitarian in two ways. First, tax and transfer spending tended to be progressive, so increasing the operation's scale was typically redistributive. Secondly, and more subtly, increasing the share of national income consumed by state services redistributed power. The private-sector was controlled through market purchases, where each *pound* had equal weight, leaving influence dependent on spending power. In contrast, the state was theoretically controlled by elections, where each *vote* was equal.

This introductory discussion suggests that tax-and-spend can be characterised as social-democratic, in my historically specific sense, when it

[3] Galbraith, J. K., *The Affluent Society* (Middlesex: Penguin, 2nd ed., 1969), p. 251. The book was originally published in 1958, just two years after Crosland's.
[4] *Ibid*, p. 247.

follows two trends. First, its overall scale increases. Secondly, progressive redistribution increases.

1.2 The British Case

1970s Britain is an especially interesting case of social democracy's demise for several reasons. First, it began under a Labour government originally pledged to heavy spending and redistribution.[5] An account seeing state contraction as the inevitable product of long-term political or economic constraints, rather than of 'political will', might thus seem especially feasible. Secondly, British experience was early so it foreshadowed "what was to happen with variations throughout social-democratic Europe in the course of the 1980s".[6] Left governments in Germany (pre-1982), France (from 1984), Greece and Spain would all retreat from social democracy along the path first beaten by Britain's 1974–79 government. Finally, Labour was succeeded by a Conservative government that survived almost two decades, and pursued anti-social-democratic policies far more determinedly than its European counterparts. Thus the original breaking of social-democratic trends seems an especially significant turning point in British history.

1.3 Historiography

The first histories of the mid-1970s represented the period as ending the post-war consensus and paving the way for Thatcherism. But their overwhelming concern was macroeconomic policy. For example, Holmes wrote:

> "The change in attitudes and ideologies after 1976 was possibly the most profound in…British politics since that engendered by the 1945–51 Labour Government… In specific terms, the post-1976 change of approach saw reducing inflation regarded as the prime policy objective ahead of full employment."[7]

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[5] *Let Us Work Together – Labour's Way Out of the Crisis* (The Labour Party, 1974a).

[6] Thompson, W., *The Left in History* (Pluto Press, 1997), p. 148.

[7] Holmes, M., *The Labour Government, 1974-79* (Macmillan, 1985), p. 182. Another 1980s political history viewing the period in the same light is: Kavanagh, D. and Morris, P., *Consensus Politics: from Attlee to Thatcher,* (Oxford: Blackwell, 1989). An economist offers similar analysis in: Smith, D., *The Rise and Fall of Monetarism* (Pelican, 1987).

It is unsurprising that Keynesianism's demise was the initial focus. The government appeared to have undergone a major macroeconomic conversion, as Callaghan's famous announcement of the death of "the cosy world…where full-employment would be guaranteed by a stroke of a chancellor's pen" showed.[8] These issues also created Labour's most bitter internal disputes.[9] Finally, from the vantage of the 1980s, the Conservatives' tolerance of 3 million unemployed represented easily the biggest break with the post-war world.

But 25 years on, this does not seem the period's enduring legacy. Unemployment, for now at least, is tending back to 1960s levels, and macro-policy has been far from consistently monetarist. Even in the 1980s monetary targeting was abandoned, and in the 1991-92 recession the automatic stabilisers were allowed to run their course, suggesting that reports of Keynesianism's death had been exaggerated. Further, later studies of the 1974-79 Labour government have stressed how distinct its macro-framework remained from that of early Thatcherism, principally because of the continuing centrality of incomes policy.[10] Most decisively, an authoritative work on the IMF crisis concluded that many of the changes earlier perceived in the mid-1970s were illusory:

> "economic policy in the last years of the Labour government differed little from what it had been before the arrival of the IMF."[11]

So, current historiography fails to find the mid-1970s the watershed it was earlier proclaimed to be. The narrow focus on macro-policy might be responsible. For while macro-policy has since been volatile, the New Right's aversion to high tax-and-spend dominated British policy through the 1980s and

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[8] Speech to 1976 Labour Conference. Cited in: Callaghan, J., *Time and Chance* (Collins, 1987), p. 414.

[9] The 1976 Labour Conference resolved the government's economic policy "has failed" and urged it should now instead "reflate the economy".

[10] Allsopp, C., "Fiscal Policy", in Artis, M. and Cobham, D. (ed.), *Labour's Economic Policies, 1974-79* (Manchester: Manchester University Press, 1990), pp. 19-37.

[11] Burk, K. and Cairncross, A., *Goodbye Great Britain* (New Haven and London: Yale University Press, 1992), p. 228.

1990s. This dominance was re-affirmed in 1997 when Labour finally returned to power: it followed tight Conservative spending plans for two years, even though these implied a substantial shrinking of the state's share of the economy.

Exceptionally, Mullard has examined the long-run significance of 1974-79 for public spending. His conclusions are striking: 1974-79 was indeed a "watershed" generating "an alternative discourse of public expenditure" which transformed it from "healer of the nation" to economic "villain".[12] But he analyses only spending: tax is excluded. Thus in explaining the mid-1970s cuts he is still chiefly concerned with the macroeconomic question: why did the government close the public deficit?

But it is possible to distinguish a separate question. *Given that the deficit was to be closed, why did a social-democratic government chose to use spending cuts rather than tax rises?* The state overreach hypothesis implies the explanation might lie in the force of long-term constraints. But no one seems to have asked whether this is valid, nor to have examined the debates by which a notionally Left-wing party arrived at the decision. This gap in the literature is my starting point.

1.4 The Rest of the Paper

Before outlining the paper, it is useful to stress what it *excludes*. First, the macroeconomic fiscal stance (i.e. the size of the PSBR) is ignored. Macro-variables, like inflation, are considered only insofar as they are may have been affected asymmetrically by tax rises as against spending cuts. Secondly, there is no attempt to evaluate public service *output*. My question is whether Labour was either constrained to accept or autonomously desired lower spending; i.e. less public-sector *input*. Important questions about whether public spending was becoming less effective and whether this influenced the government are distinct.

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[12] Mullard, M., *The Politics of Public Expenditure* (Croon Helm, 1987), pp. 149-50.

Chapter 2 shows how the mid-1970s broke social-democratic trends in tax-and-spend. The following two chapters examine the role of exogenous pressures on the government. Chapter 3 appraises economic arguments suggesting tax-and-spend needed to be cut, and Chapter 4 uses opinion polls to ask whether the public's tax-intolerance effectively implied an electoral constraint. Aside from the 'objective' importance of these constraints, both chapters also look at the role they played in Labour's internal debate. Chapter 5 analyses this debate further, but moves the focus onto Labour's changing ideas, establishing that parts of the party ceased to support high tax-and-spend, whilst others ceased to defend it. Chapter 6 concludes.

The main primary research is in analysis of the debate. Unfortunately, Cabinet papers remain unavailable under the thirty-year rule. But extensive use has been made of minutes of internal Labour committees, which seem to have been little used and which represent an obvious substitute in that a ten-year confidentiality rule applies. These have the advantage of revealing opinion in the broader Labour Movement (unions and party) as well as in the government. Interviews are also a key primary source. Finally, the many published diaries and memoirs have been employed.

2: Were the Mid-70s a Turning Point?

Section 1.1 suggested social-democratic fiscal policy exhibited two trends: overall growth in tax-and-spend, and increasing redistribution. This chapter aims to show the mid-1970s were a watershed that broke both. Turning points in aggregates will be related to changes in parameters that politicians directly controlled, to suggest changes were to some extent deliberate, not the automatic product of macroeconomic performance.

2.1 The Size of the State

Before examining the evolution of public spending, a methodological issue must be cleared up. Public spending trends can be importantly affected by the relative price effect – the tendency for costs, especially unit-labour-costs, to grow faster in the public sector because its service-dominated activities have less capacity for productivity growth than the rest of the economy. Consequently, if spending is assessed in volume terms (i.e. in constant, rather than current, prices) its growth appears slower.[13] But for my purposes the current-prices measure is most relevant, as this determines the required tax burden. So, most series will be calculated on a current basis.

Overall, the Twentieth Century saw huge growth in the state's share in the economy.[14] Both World Wars saw unprecedented government resource-mobilisation. A 'ratchet' or "displacement effect" has been seen in government's subsequent failure to retreat to its peacetime role.[15] Indeed, after the second demobilisation, the state continued growing. By the 1970s this growth seemed automatic and irreversible.

Figure 2.1 shows government income (GGR, roughly equalling the 'tax burden') and spending (GGE) in GDP, 1950-2000. On the spending side, the

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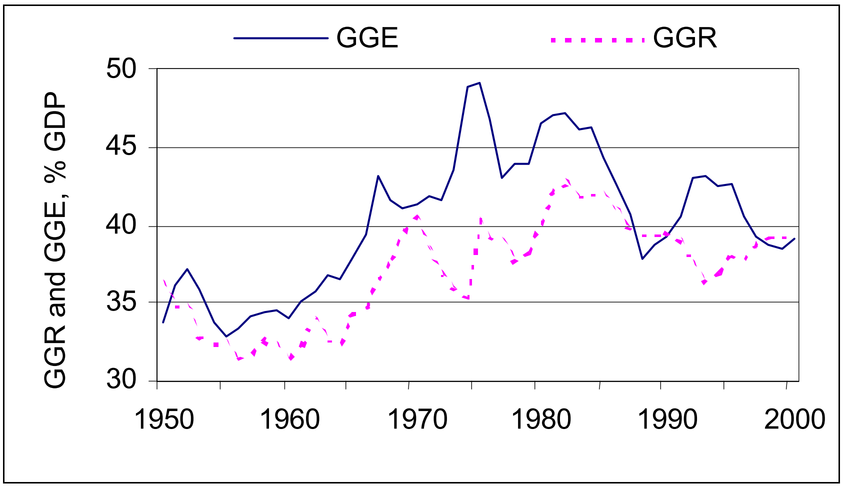
[13] For discussion of how the relative price effect affects measurement of British spending trends, see Hatton, T. J. and Chrystal, K. A., "The Budget and Fiscal Policy", in Crafts, N. F. R. and Woodward, N. (ed.), *The British Economy Since 1945* (Oxford: Oxford University Press, 1991), pp. 52–62.

[14] For trends in *Blue Book* aggregates over the whole Twentieth Century, see Dilnot, A., and Emmerson, C., "The Economic Environment", in Halsey, A. H., and Webb , J. (ed.), *Twentieth Century British Social Trends* (Macmillan, 2000), pp. 324-57.

mid-1970s are a clear long-run turning point. Before 1975, apart from contraction in the mid-1950s (caused by the post-1953 Korean War demobilisation) GGE trended upwards, from 32.4% of GDP in 1956 to peak at 49.3% in 1975, with growth being especially rapid in Labour's first year, 1974-75. Since then, despite fluctuations, it has trended down, to below 40% in the late 1990s. The short-run path followed by GGR under Labour was similar. The year to 1975 saw the tax burden expand from 35.4% to 40.3%, the biggest annual increase shown. Immediately afterwards GGR fell back, to 37.6% by 1978.

Figure 2.1: Government Spending and Income, 1955/95[16]



Still, there might seem to be two problems with viewing the mid-1970s as a long-term turning point, although neither is decisive. First, Heath's early 1970s tax cuts had already interrupted the tax-burden's 1955-70 growth. But these tax cuts were not matched in spending reductions, so were unsustainable and thus cannot represent a long-term turning point. In contrast, 1975-78 was

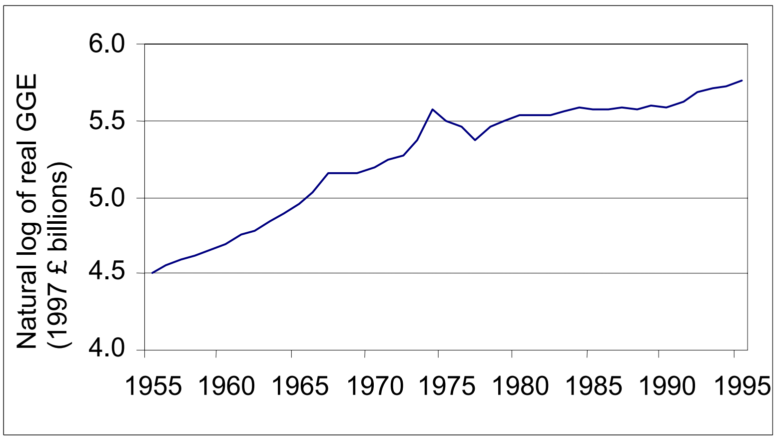
[15] The second term dates from: Peacock, A. and Wiseman, J., *The Growth of Public Expenditure in the UK* (Princeton: Princeton University Press, 1961).
[16] Pre-1965 figures calculated from: Feinstein, C. H., *Statistical Tables of National Income, Expenditure and Output for the UK, 1855-1965* (Macmillan, 1976). 1965-95 figures calculated from: CSO, *National Income and Expenditure: The Blue Book* (HMSO, various years). 1995-2000: GGR figures calculated from HM Treasury, *Financial Statement and Budget Report* (The Stationery Office, various years); GGE taken from ONS website. Post-1998 figures provisional.

the significant break with post-war tax trends, as reductions after 1975 were more than matched by lower spending.

Secondly, that 'rolling back the state' began in the mid-1970s is obscured by the increase in both series in the early 1980s – indeed, the tax-burden only reached its long-run peak in 1982. But these developments reflected *macro*-economic performance and policy, not *structural* levels of tax-and-spend: recession depressed the denominator, unemployment boosted GGE and fiscal orthodoxy meant tax was increased commensurately. Once recovery began, in 1982, it gradually become clear that GGE and GGR had contracted structurally in the economy since the 1970s. And although the early 1990s recession again interrupted the state's contraction, even 3 million unemployed left GGE below earlier heights.

Another time-series that illustrates the mid-1970s break is absolute, real public spending. This requires constant prices, so the relative price effect may have a bearing. Figure 2.2 shows the natural log of total public spending. Two points stand out. First, 1975-77 is the only recent period to have witnessed substantial *reductions* in spending. This is because, unlike in

Figure 2.2: Real Government Spending, 1955/95[17]

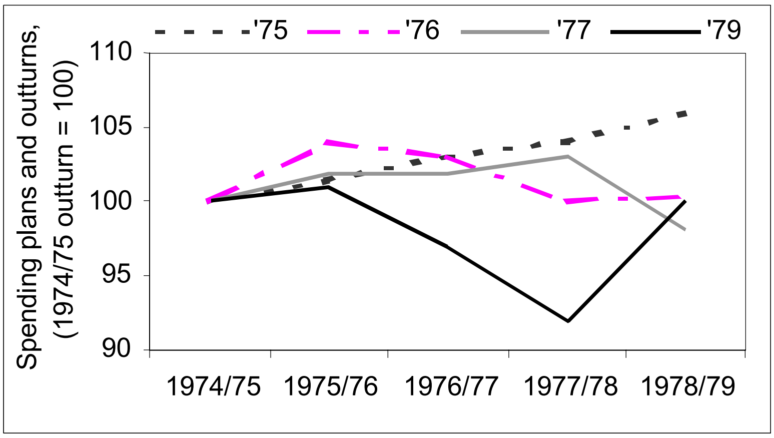


[17] Pre-1965 from Feinstein (1976); post-1965 from CSO (various years).

later periods when public expenditure's GDP share shrunk, in the mid-1970s GDP itself was stagnant. Secondly, the mid-1970s divide the post-war era of rapid spending growth from the succeeding era with much lower trend-growth.

Between 1974 and 1979, then, Labour presided over first *acceleration*, and then *reversal* of the post-war trend for rapid state growth. Figure 2.3 links this to *planned* spending policy. It shows spending totals in annual Expenditure White Papers, one line being drawn for each Paper shown: for years earlier than each Paper's publication, the totals are recorded outturns; for years after publication, they represent government plans. Thus the line representing the 1979 White Paper simply records the actual path of spending up until 1978/79, whereas the line for the 1975 White Paper represents spending *plans* for each year.

Figure 2.3: Spending Totals in Selected Annual White Papers[18]



The 1975 White Paper planned for continuous growth. 1976 marks a decisive break: its White Paper budgeted for unprecedented cuts. This might partly reflect the unduly pessimistic 1976 forecasts, which suggested that 1975/76 spending would exceed the 1975 plans. This implied cuts were required if the planned path was to be returned to. But the huge cuts budgeted for right through to 1979/80 represented huge over-compensation if this was the only aim. Further, if reversion to 1975 plans was intended, spending should

[18] Collated from White Papers by Mullard (1987), table 5.1, p. 152.

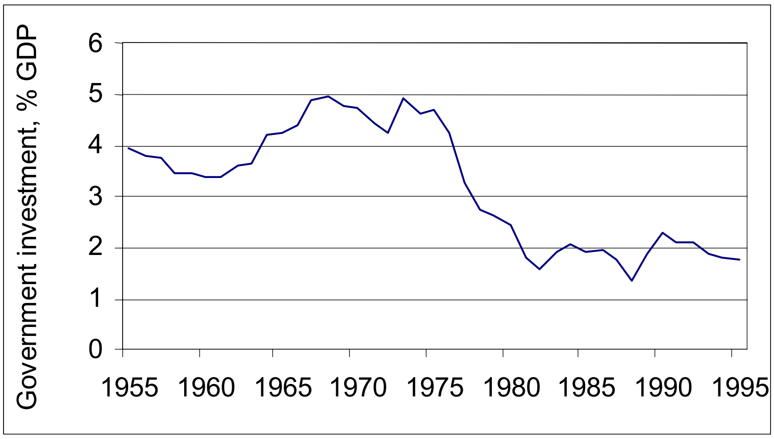
have readjusted upwards when outturns revealed (in 1977) that 1976 projections had been unduly pessimistic, substantially over-estimating spending. But subsequent White Papers are shown to have stuck roughly to the 1976 strategy. So long-term plans changed in 1976.

Two other points are interesting. First, cuts were bigger than planned. This is seen in the outturn 1979 figures, which show spending consistently fell below planed levels. Nonetheless, policy was important in planning the direction of change, even if it did not control the magnitude. Secondly, the decisive policy change preceded the 1976 Sterling and IMF crises. The crucial 1976 White Paper was published in February, but pressure on the pound began only in March 1976. The 1977 White Paper, published immediately after the final IMF crisis, did not radically alter the 1976 plans: the average level of spending planned for the years 1977/78 and 1978/79 was very similar in the 1977 and 1976 White Papers.

One feature of the cuts had special significance for the future size of the state – their heavy bearing on government investment. Retrenchment commonly hits investment, as its reduction lacks the short-run consequences of cutting current services. But large and sustained investment cuts are significant as they reveal changes in the path of overall future spending the government envisages: a decision to build one less hospital now implies less future current-consumption, as it will no longer be necessary to provide it with staff. Figure 2.4 charts government investment since 1955.[19] Its relative size increased until the mid-1960s, and then fluctuated at 4% - 5% till 1976. It then fell sharply till 1982, since when it has been around 1.5% - 2%. Labour oversaw the major part of the contraction: from 4.7% in 1975 to 2.7% in 1978. So in a very direct way, cuts to investment in the 1970s paved the way for the overall shrinking of the state in the economy in later years.

Figure 2.4: Government Investment in GDP[20]

[19] Figures are for local authority and central government investment. Following OECD practice, investment by the nationalised industries is excluded.
[20] Pre-1965 from Feinstein (1976); Post-1965 from CSO (various years).



On the tax side, as well, various indicators suggest 1975/76 divides a period of statism from one of cuts. The detail of tax policy is analysed in Section 2.2, but it is worth linking the decline of the tax-burden with policy-controlled parameters that determined revenue from the two most significant types of tax – income tax and expenditure taxes.

The most important determinants of income tax revenue are the basic rate and the personal allowance. By mid-1975, Labour had increased the basic rate by 5% to 35%. But by 1978 they had reduced it to 33%.[21] Likewise, Labour initially ran down the personal allowance's real value from £3952 to £2906 (1997 prices). But from 1976 it increased, reaching £3225 by 1977.[22]

The initial eagerness to raise revenue is evident in the introduction of higher-rate (25%) VAT on luxury goods in November 1974. The subsequent tax-cutting policy is equally clear in its halving (to 12.5%) in April 1976.[23] The late 1970s reluctance to increase tax is also clear in low excise duties. Petrol and tobacco yield most excise revenue, yet total real tax on both (*ad valorem* and specific components) was lower in Labour's last full year than at any time since the early 1960s.[24] The implication is that had Labour wished to pursue

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[21] HM Treasury, "The Treasury Tax and Benefit Reference Manual" (unpublished internal document, 1995), Table 1.5.
[22] Calculation based on: average earnings (from ONS website), and HM Treasury (1995), Table 1.5.
[23] HM Treasury (1995), Table 2.1.
[24] HM Treasury (1995), Table 2.7.

higher tax (ignoring, for now, distributional effects) historical precedent suggested excises offered ample room.

Overall, there is strong evidence that long-term trends in the volume of tax and spending were reversed from the mid-1970s, and that policy was important in this.

2.2 Redistribution

The second social-democratic fiscal trend is increasing progressive redistribution. Egalitarian policy involves altering the incidence of tax across the population, by increasing reliance on tariffs that relate to ability to pay, like income tax, and reducing that on those that ignore financial circumstance. It also involves setting the schedules of individual taxes (rates, bands, and the tax base) so more of the burden falls on the better-off. Additionally, spending policy may have a role, through increasing the relative weight of expenditure that disproportionately benefits the poor – notably cash benefits, and some direct provision, like housing.

Figure 2.5 shows the Gini coefficient – a measure of income inequality – from 1961 until the late 1990s. 1977 is revealed as a turning point, when a short period of declining inequality ended, and an upward trend began which has continued ever since. Other measures of income inequality also reveal the mid-1970s as a turning point.[25] This seems suggestive of Labour having abandoned redistributive policies. But policy is only one determinant of inequality – wages, employment and demographics are all crucial. So, to confirm that changing patterns of tax-and-spend helped underpin this change we need to examine the latter more directly.

Figure 2.5: Gini Coefficient on Household Incomes, 1961-97[26]

[25] Pre-1979 figures from: Goodman, A. and Webb, S., *For Richer, For Poorer*, Commentary no. 42 (Institute for Fiscal Studies, 1994). Post-1979 from: Clark, T. and Taylor, J., "Income inequality: a tale of two cycles?", *Fiscal Studies*, Vol. 20, No. 4 (1999), pp. 387-408.

[26] References as in footnote 25. Data derived from Family Resources and Family Expenditure Surveys. Income is net, and before deduction of housing costs. Incomes are adjusted for family size.

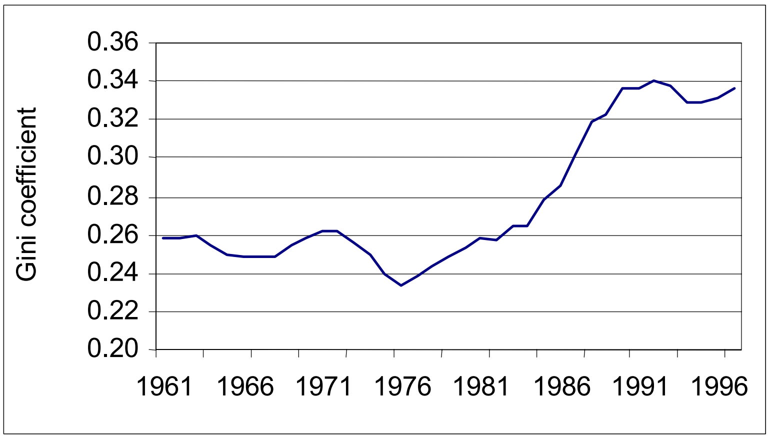
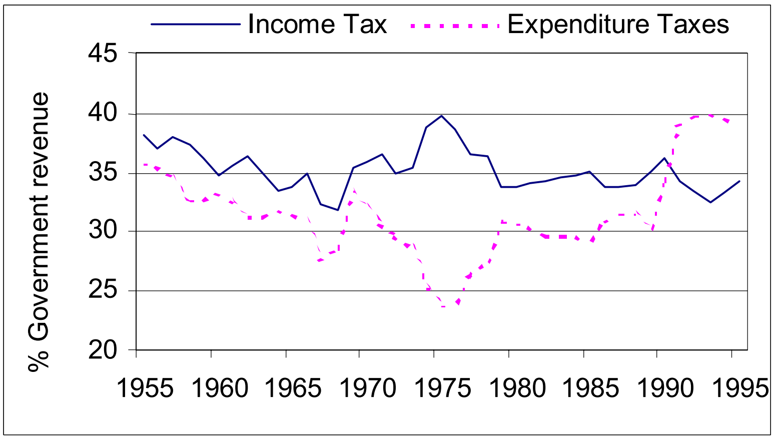


Figure 2.6 charts the share of government revenue coming from income tax and expenditure taxes. From the late 1960s expenditure taxes was substituted for a greater reliance on income tax. Whereas in 1964 income tax revenue exceeded expenditure taxes by a mere 5%, by 1975 it raised two-thirds more revenue. In Labour's first two years this social-democratic trend was accelerated, but then it moved into reverse. From 1976, the relative importance of income tax waned sharply. Since 1979 this trend has been extended so that by the 1990s expenditure taxes revenues exceeded income tax. The income tax cuts discussed in section 2.1 were largely responsible for this move from progressive types of tax after 1976.

Increasing reliance on regressive taxes was coupled to the cessation of attempts to make individual taxes more progressive. Income tax can be made more progressive in two main ways – increases in the rates applied to higher incomes; and, reductions in the higher-rate threshold (cuts to the higher-rate threshold imposed a flat-rate levy on all those with incomes above it).

Figure 2.6: Relative Reliance on Income and Expenditure Taxes[27]

[27] Pre-1965 from Feinstein (1976); Post-1965 from CSO (various years).

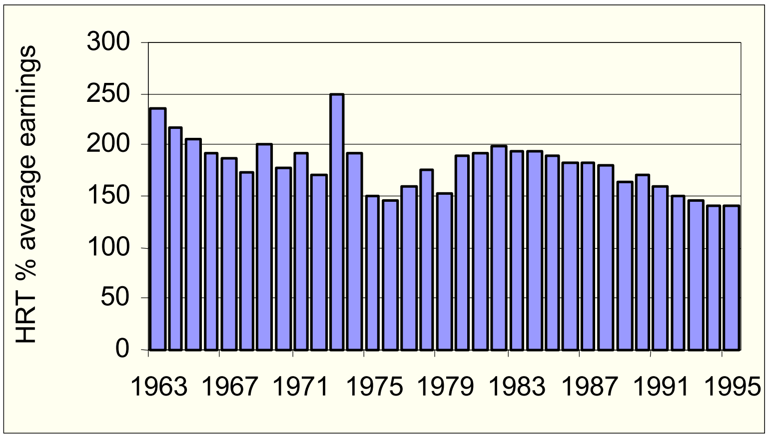


In Labour's first years both policies were followed. In 1973/74 there were eight higher-rates. By mid-1975, all but the top had increased by 5 percentage points, so that they ranged from 45% to 75%. The top rate had increased by 8 points to 83%.[28] But after 1976 no increases were made. Figure 2.7 shows how the higher-rate threshold fell from 249% of average earnings in 1973 to just 145% in 1976. This was mostly due to the effect of inflation, but also reflected a £500 higher-rate threshold cut in Healey's first budget. After 1976, the higher-rate threshold increased substantially, to 178% of average earnings in 1978.

In reform of National Insurance Contributions, too, Labour initially increased progressivity. It helped the lowest-paid, by removing completely their (previously substantial) burden in 1975.29 But again, progressive change ceased in 1975.

[28] HM Treasury (1995), Table 1.10.
[29] HM Treasury (1995), pp. 3.7-3.9.

Figure 2.7: Higher-Rate Threshold (HRT) as Proportion of Average Earnings[30]



A final indicator of changing tax progressivity is variation in the total burden across the earnings distribution. Figure 2.8 charts average direct tax-rates (income tax *and* National Insurance) at different fractions of average-earnings for a single person. It shows that Labour's first two years effected a progressive increase in the spread. For example, the gap between the burden at average and twice-average earnings stood at 1.5 percentage points in 1973, but by 1976 was 3.8 points. Afterwards, this gap again closed, to 2.4 points in 1978. After 1975 the spread of average rates between the lowest (50% average) and highest-paid (200%) also declined – from a peak of 10.8 to 10.2 points by 1978.

Overall, in Labour's early years, it not only raised taxes, but did so in a progressive manner. In later years, when making tax cuts, it delivered these regressively.

Equivalent definitive analysis of the distributional effects of spending is impossible – contentious assumptions would be needed. But *Blue Book* data suggests Labour's post-1976 cuts policy was not implemented in a consistently egalitarian manner.[31]

Figure 2.8: Direct Tax Burden at Different Fractions of Average Earnings[32]

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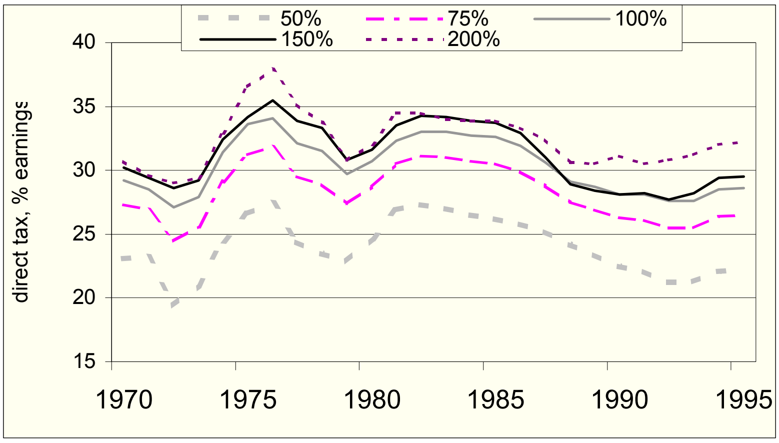
[30] Calculation based on average earnings (from ONS website), and HM Treasury (1995), Table 1.10.

[31] Compiled in Mullard (1987), Table 5.2.

[32] Ibid, Table 13.6d.



On the one hand, the share of social security in total public spending grew, from 19% in 1975 to 25% in 1978, which might suggest egalitarianism. One Labour policy, was important in this – the pensions *earnings ratchet*. In 1974, the government passed legislation committing itself to increase pensions with the highest of price- or wage-inflation. As Labour never repealed this, its effects continued even as cuts were embarked on – as late as 1979/80 real pensions increased substantially.[33] And this policy was certainly progressive: pensioners dominated the bottom of the 1970s income distribution.[34]

But the DHSS budget reflected more than policy: it was largely 'entitlement-driven', rising automatically with the ageing population and increasing unemployment. Indeed, it continued to expand rapidly after 1979, in spite of explicitly Rightist policies. And cuts in *discretionary* spending seem to have been delivered less social-democratically. Social welfare programmes that most disproportionately benefited the worst-off were hit hard – for example, housing dwindled from 12.0% of spending in 1974, to just 8.3% in 1979. Yet at the same time certain non social-democratic programmes actually gained relative ground: defence increased its share from 11.0% in 1974 to 11.8% by 1978. This is further evidence, then, that Labour's later years saw the abandonment of social-democratic policy.

[33] HM Treasury (1995), Table 13.3.
[34] Goodman, A., Johnson, P. & Webb, S., *Inequality in the UK* (Oxford: Oxford University Press, 1997).

3: The Role of Economic Constraints

Labour, then, accelerated the long-term social-democratic thrust of fiscal policy for two years before forcing it into reverse. This requires explanation. One possibility is that the economic limits of social democracy had been reached. Such constraints could have been structural, in which case they did indeed represent long-run limits. Or, they could have been transient – meaning only that extending welfare and redistribution was ruled out in the particular economic climate of the time.

This chapter analyses four economic arguments suggesting that tax-and-spend might go too far. In turn, each is outlined before its 'objective' bearing on 1970s Britain is evaluated. Finally, its weight in Labour's internal debate is considered.

3.1 The Bacon and Eltis Thesis

The Argument

In the *Sunday Times*, economists Bacon and Eltis publicised the argument that Britain's long-term problems reflected public high spending.[35] Resource crowding-out was the responsible mechanism.[36] Government spending denied resources to the sales-financed 'market-sector' which ultimately funded non-market activity through tax. Powerful unions offset high tax with wage-demands, leaving squeezed profits and depressed market-sector investment (and ultimately output) the counterpart to high state spending. Britain was impoverished because productivity growth was fastest in the market-sector. High public spending might be ultimately unsustainable because the revenue from particular tax-rates declined with market-sector output. Finally, as the market-sector produced tradables, its contraction left a weak current account.

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[35] The first of the three articles was: Bacon. R., and Eltis, W., "Too few producers: the drift Healey must stop", *Sunday Times*, 14th November 1975. Later expanded into a book: Bacon. R., and Eltis, W., *Britain's economic problems: too few producers* (Macmillan, 1976).

[36] This must be distinguished from 'financial crowding-out', which reflects high government borrowing and can be attacked by tax rises as well as by spending cuts.

Evaluation

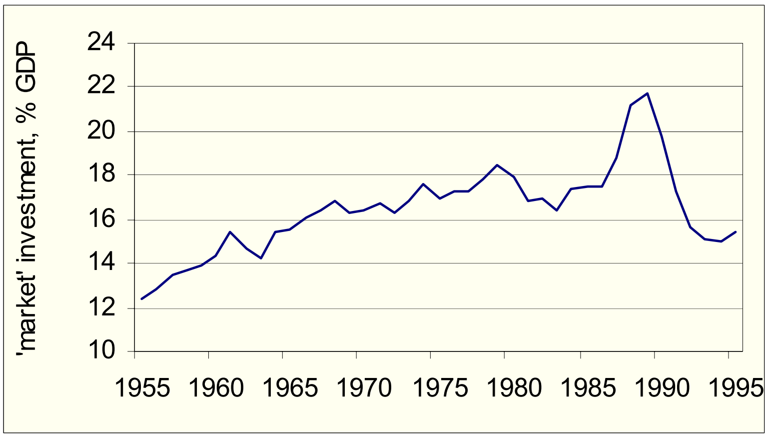
Bacon and Eltis pointed to a few striking statistics to back their case. In particular, they contrasted the contraction of 'market' employment, with state expansion: for example, local government service manpower had grown 70% since the early 1960s.[37] Average real-net-pay had increased just 14% from 1964 to 1974, while the direct tax paid by the supposedly typical family had increased nearly 100%.

But there were serious weaknesses. First, the possibility that cutting government staff would produce unemployment instead of manufacturing jobs was not seriously considered. Yet experience in the late 1970s and 1980s – when the public-sector staff stopped expanding and unemployment soared – suggests this scenario is the more credible. Secondly, the evidence is selective. Exclusive focus on take-home *pay* to gauge living standards meant benefit-dependent groups, like the jobless and the retired, were simply excluded from the analysis. And 'ominous' figures on the state's growth in GNP, are misleading, because much of the growth reflected transfer payments that cannot produce resource crowding-out.

Most decisively, market-sector investment did not fall, as Figure 3.1 shows. In the decade from 1964-74 overall – public and private – market-sector investment, rose from 15.4% to 17.7% of GDP.[38] Even if the private sector is considered alone the fraction increased from 11.3% to 13.8%. And the 1975 recession did not produce a major departure from this long-run trend.

[37] Bacon and Eltis (1976), pp. 11-12.
[38] Public corporations were, even for Bacon and Eltis, 'market-sector' as chiefly funded by sales.

Figure 3.1: Market-Sector Investment in GDP, 1955/95[39]



Influence

Whatever its merits, did the Bacon and Eltis thesis influence the policy turnaround? Not, it seems, through the thinking of the Treasury itself. Its head at the time recalls:

> "We studied, and were unimpressed by the piece…[it] seemed to us far too simplistic. We believed that you had to look in a much more microscopic way at the options than adopt a broad-brush view like that."

He believed that Treasury ministers were also "not very impressed" and certainly did not "recast their policies because of [the thesis]".[40]

But Healey did deploy the argument to push the acceptance of cuts. He told ministers:

> "'there was severe imbalance' in the economy… We have got to close the Balance of Payments gap by 1978… We couldn't go on diverting manpower from productive industry at this rate."[41]

In public statements, too, the argument was deployed. For example the minor cuts of early 1975 were advanced on the grounds that: "the paramount

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[39] Post-1965 figures: CSO (various years); pre-1965 figures: Feinstein (1976).
[40] Interview: Sir Douglas Wass.
[41] Castle, B., *The Castle Diaries, 1964-76* (Macmillan: London, 1990), p. 633, 14th July 1975.

need to move resources into exports and investment make it essential to contain the demand on resources made by public expenditure."[42]

But the argument that resources were a constraint lost credibility, as unemployment rose from mid-1975. Healey's demands for cuts met effective reply in July 1976 when Benn argued: "the idea that you have got to make room [for investment] is simply not credible" given the unemployment.[43] The Chancellor thus played it down in the next cuts debate.[44] By late 1976, it was shelved completely: Rodgers, who was only in cabinet for the last cuts debate, does not recall the argument being discussed at all.[45]

The supposed 'resource constraint' was not influential in the Cabinet decision to accept cuts. But the thesis had a role in persuading the Labour Party beyond government to accept cuts. Soon after the *Sunday Times* article, the Labour Office argued new growth would permit little new spending as resources were needed for investment and the trade-balance.[46] The HPC was not immediately persuaded, making "a number of sharp criticisms" of their report and rejecting it.[47] But the basic argument survived into a later office document that the HPC approved. State resources, it stated, would be "especially limited in the two years between now [1976] and 1978", because investment and exports had to improve.[48]

3.2 Inflation Concerns

The Argument

Tax rises increased inflation in two ways. Indirect taxes directly increased prices, while direct tax generated cost-push inflation by increasing wage-demands. Generally the argument concerns the possibility that tax rises might worsen an (existing) inflationary spiral in the short-term. But Bacon and

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[42] Public Expenditure, Cmnd 5879 (HMSO: London, 1975), p. 3; cited in Mullard (1987), p. 148.
[43] Benn, T., *Against the Tide* (Arrow, 1989), p. 589, 2nd July 1976.
[44] Benn (1989), p. 591, 6th July 1976.
[45] Interview: Lord Rodgers.
[46] NEC Box LXI. HPC: RE:409/Jan 1976; *Costing Labour's Programme*.
[47] NEC Box LXI. HPC: 12th January 1975.
[48] NEC Box LXII. HPC: RE:509/March 1976; *The Economy and Public Spending*.

Eltis went further and argued that the long-term growth of tax-and-spend in Britain substantially underlay the increase in its inflation since the end of the 1950s. The effect was especially potent because of powerful unions. But the root problem was with tax, not the unions: excessive tax led moderate men to elect militant union leaders who would push for big wage increases, as this was the only way to preserve take-home pay.[49]

Evaluation

The view that the *long-term* growth of the state explained 1970s inflation is extremely weak. The state had grown hugely from 1900, but inflation trended up only from the 1960s. And even in the twenty years to 1975, the percentage of aggregate earnings represented by direct tax (not all of which actually fell on earnings) increased only from 20.6% to 24.5%.[50] The overall wage bill would have had to increase by just 5.2% had workers been compensated 100%.[51] This would have required an annual increase of just 0.25% per year in wages, and an even lower increase in overall costs, clearly, a small fraction of price- or wage-inflation over the period.[52] Besides, the stagnant net-wages, which Bacon and Eltis highlighted, showed far less than 100% of extra tax was actually passed on. So inflation was not a permanent obstacle.

But short-term tax effects cannot be easily dismissed. The negative effect of indirect tax increases was seen, for example, in 1979 when Thatcher's government increased VAT from 8% to 15%. Inflation increased sharply, from 10.3% in May to 17.4% in November of 1979, in spite of tight macro-policies.[53] In the 1970s, the immediate effect would have been aggravated by TUC's uncharacteristically militant opposition to even modest indirect tax hikes. For example, when, in 1975, Healey introduced luxury-rate VAT, the

[49] Bacon and Eltis (1976), pp. 6-8.
[50] Data: post-1965: CSO (various years); pre-1965: Feinstein (1976). Calculation: aggregate earnings over total direct tax.
[51] (1 – 0.206) / (1 – 0.245) = 1.052.
[52] 20th root of 1.052 = 1.0025.
[53] ONS website.

TUC argued unions could legitimately "compensate for living standards" that the decision imperilled.[54] Thus major indirect tax hikes would have had the second-round inflation effect of undermining the pay-policy.

By contrast, direct tax rises had ambiguous short-run effect. They impacted negatively if passed on by employees. Even if direct tax was irrelevant to the long-term (1960-75) inflationary trend, short-run effects might have been important: tax increases were concentrated in certain years, like 1974 and 1975, when they might have been important in wage-bargaining. Big increases in these two *successive* years made this more likely as unions would have learnt that defending living standards required attention to net wages. But against this, the effect of Labour's 'social contract' must be considered: trade unionists would give "their free acknowledgement that they [had] other loyalties" than those to their own members in pay-bargaining, in return for redistribution and welfare.[55] Tax-and-spend would cut inflation as unionists would accept pay-moderation in return for social democracy.

Did the positive or the negative effect prevail? Before July 1975, despite growing tax-and-spend, pay exploded: increases in central government reached 40% in 1975's second quarter.[56] But this is not decisive, as there was no clearly defined pay-policy, so even sympathetic unions pushed maximal claims to avoid being left behind in the wage-price spiral. And the TUC agreed a tight pay-policy immediately after big direct tax rises in July 1975: its operation coincided with inflation falling from its August 1975 peak, 27.9%, to 12.9% in July 1976.

Further, the union leaders consistently tried to negotiate wage-moderation for welfare. For example, discussing with Healey the "balance of reflation" for 1976, the TUC dismissed his focus on take-home pay and instead "pressed the Chancellor on a regular six-month interval between pension

[54] NEC Box LX. Liaison Cttee: 21st April 1975.
[55] "Britain will win with Labour" (The Labour Party, 1974b), pp. 242-43.
[56] Ormerod , P., "Incomes Policy", in Artis, M. and Cobham, D. (ed.) *Labour's Economic Policies, 1974-79* (Manchester: Manchester University Press, 1990), p. 59.

increases."[57] Even after the 1976 Budget showed Healey had abandoned tax-and-spend, unionists tried to link the pay-policy to social policy pledges.[58] Indeed, even in 1978 the TUC opposed "any question of putting the preponderant weight of fiscal-expansionary measures in the next few years into tax reductions rather than on the expenditure side."[59] Further, they seemed genuinely tolerant of direct tax rises: those in the 1975 Budget were not criticised.[60]

But union *leaders* were increasingly apart from their members in their relative indifference to privately financed consumption, as real-pay stagnated from 1975. In 1977 Jack Jones told a journalist that "when he went round factories workers knew what was happening to prices and dividends and they simply shouted at him" for acquiescence in pay-policies.[61] In 1978 Jones retired, and TGWU members chose Moss Evans to succeed him, who stood as an anti-pay-policy candidate, being more concerned with net wages than pension increases. The gulf was confirmed in Winter 1978/79, when pay-policy collapsed in a wave of unofficial strikes, which suggested ordinary workers did indeed put private wages first.

General conclusions about the inflation effect of direct tax are tentative. Union leaders were willing to contain wages in return for social democracy, and they did this with some success in 1975-76. But after this time their influence waned as sustained negative net real-wage growth proved unacceptable to workers accustomed to annual rises. Econometric evidence bolsters this view. There was genuine success in 1975-76, but later pay-policies were ineffective, changes in wage-inflation being fully explained by macro-factors, like unemployment.[62] Thus, after 1976 rising tax-and-spend might well have been inflationary.

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[57] NEC Box LXII. Liaison Cttee: 26th January 1975.
[58] See, for example: NEC Box LXIII. Liaison Cttee: 24th May 1976.
[59] NEC Box LXVIII. Liaison Cttee: 21st Nov 1977.
[60] NEC Box LX. Liaison Cttee: 21st April 1975.
[61] Cole, J., *As it seemed to me* (Weidenfeld & Nicolson, 1995), p. 176.
[62] See Ormerod (1990), which includes original tests and reviews other econometric work.

Influence

All ministerial factions agreed that inflation was central in setting tax-and-spend.[63] But some believed it meant tax-cuts were needed, while others, like Castle, argued instead that the "concept of the 'social wage'" would persuade unions "not to press excessive wage demands", making social democracy the solution.[64] Initially, these views dominated. Even in early 1975, as wage-inflation peaked, Healey attempted genuine social-wage bargaining, telling the unions: "the amount he could increase expenditure would depend on the rate of inflation", and so on pay.[65] And the 1975 Budget showed deflation by tax rises was still preferred.

A minority always dissented. Healey's deputy found the 1975 Budget "disturbing" for tackling inflation only "from the angle of increased taxation".[66] He doubted whether unionists spoke for their members and asked whether:

> "the truth of the matter is that in asking for an increased social wage those who are doing so are not speaking for their members in giving [it] a higher priority than personal expenditure?"

He warned it was likely that real-wage increases would soon reveal that the "people are setting different priorities", and necessitate spending cuts to control inflation.[67]

By around the time of the 1975 Budget, Healey and some other ministers were converted to this view by the persistence of high inflation. When Healey first demanded substantial cuts, "wage-inflation" was his first argument for making them. In backing his demands, Jenkins particularly stressed the "wages issue".[68] But this view still did not prevail and cuts were postponed. But in mid-1975 even the Left perceived the concern. Foot publicly

[63] Interviews: Lord Shore; Lord Rodgers; Lord Lipsey (recalling Crosland's views).
[64] Castle, B., *Fighting All the Way* (Macmillan, 1993), p. 498 and pp. 606-07.
[65] NEC Box LIX. Liaison Cttee: 25th February 1975.
[66] Dell, E., *A Hard Pounding* (Oxford: Oxford University Press, 1991), p. 121. Throughout the memoir Dell's ongoing concern with market opinion is clear.
[67] House of Commons debate cited in Dell (1991), p. 149.
[68] Benn (1989), pp. 356-57, 25th March 1975.

acknowledged in June 1975: “Most of the pressure [on wages] for the past year or two has been from the rank and file.”[69]

By autumn 1975 Healey could use the argument with success in Cabinet to dismiss the alternative of tax increases: these would encourage workers to “bargain on post-tax incomes”.[70] When the significant cuts were first announced, Healey argued to the unions that these were beneficial as they would allow lower tax. Thus in 1976 there were repeated bizarre exchanges where supposedly social-democratic ministers foisted increased net pay (through tax cuts) on unions whose support for tax-and-spend made them reluctant to accept. For example, Healey told the unions: “The most important single thing that could be done to improve the social situation” was not social spending but “to raise tax thresholds”.[71] Again, he argued the pay-policy required he “compensate for a lower [pay-rise] limit through the tax system”.[72]

Inflation played a far lesser role in subsequent cuts debates: Callaghan gave five reasons to back the IMF cuts, which did not include inflation.[73] Indeed, when inflation was mentioned it was by ministers opposed to cuts: Benn for example, suggested that cuts would lead the unions to argue: “if you bust your side of the Social Contract, then we’ll bust ours”. He claimed they would thus “go for big wage claims”.[74] Even though in December 1976 inflation was probably becoming a genuine reason for cuts, it was not felt to be so as (unlike in 1975) a successful wage-policy had operated for over a year, while the TUC continued to stress ‘social priorities’ over wages.

3.3 Marginal Rates: The Laffer Curve & The Poverty Trap

The Argument

Marginal tax creates dead-weight loss through the substitution effect. In practice, the concern of ‘supply-side’ economists has been that high tax-rates

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[69] Commons debate. Quoted in : Jones, M. *Michael Foot* (Gollancz, paperback ed., 1995), p. 385.
[70] Benn (1989), p. 461, 13th November 1975 and p. 475, 9th December 1975.
[71] NEC Box LXII. Liaison Cttee: 26th January 1975.
[72] NEC Box LXII. Liaison Cttee: 22nd March 1975.
[73] Benn (1989), p. 673, 2nd December 1976.

blunt incentive, and so reduce effort. An implication stressed by the New Right is that at high tax-rates further increases may cut revenue: the Laffer effect.[75] A 100% rate removes all incentive to supply the taxable good and so yields no revenue. Assuming revenue is a continuous function of the rate, then some rate below 100% is a genuine limit in that further increases would cut yield. Even if overall tax rises remained possible, Laffer effects could apply at the top rates of tax, leaving tax at the limits of its power to redistribute: further notionally progressive changes would cut revenue from richer families. A more characteristically social-democratic concern is the *poverty trap*: high effective marginal rates being imposed on the poor by the interaction of tax and the withdrawal of means-tested benefits.

Evaluation

Empirically, the Laffer thesis seems inapplicable to the rates prevalent in most tax-systems. Certainly, increases in the basic rate of income tax (whose 1970s peak was 35%) would have yielded revenue. But the very top rates may have approached the limit. The Laffer effect has been found in Sweden, whose top-rates compared with 1970s Britain.[76] And assuming the elasticity of labour-supply is fairly high (0.2), then an estimate of the Laffer limit would be 83%, precisely the top-rate on earned income from 1974 to 1979.[77]

Even so, the limits of tax-progressivity had not been reached. First, further higher-rate increases *might* have been possible. A 1968 study (when the top effective rate on earned-income was even higher, 96.25%)[78] found 70% of even the highest-paid reported no disincentives, and even those that did worked

[74] *Ibid*, p. 677, 2nd December 1976.
[75] Named after President Reagan's advisor, Professor Arthur Laffer.
[76] Stuart, C. E., "Swedish Tax Rates, Labour Supply and Tax Revenues", *Journal of Political Economy*, Vol. 89, No. 5 (1981), pp. 1020-38.
[77] Assuming perfectly elastic Labour demand, revenue begins to fall when the elasticity of labour supply (assumed to be 0.2) exceeds: $(1 - t) / t$, where t is the tax-rate. This term is 0.204 where $t = 0.83$ but 0.190 if $t = 0.84$. See Hal R. Varian, *Intermediate Microeconomics* (New York: W.W. Norton, 3rd ed., 1993), pp. 279-80 for derivation of this term.
[78] Calculated from HM Treasury (1995), Tables 1.5 and 1.6.

no fewer hours, calling into question the significance for revenue.[79] Secondly, even if increasing the top rate were not possible, increasing other higher-rates or cutting the higher-rate threshold remained so: both were progressive as only higher-rate taxpayers suffered.

Even if the extreme Laffer case is irrelevant, concern that high marginal rates imposed inefficiency or threatened a fair return to effort might still have made the government reluctant to increase them. But even then, progressive tax rises were possible by expanding the tax base, most particularly to include income used to pay mortgages. Even after Labour's 1974 reform, interest on mortgages up to a (generous) £25,000 was offset against tax.[80] The wealthy benefited disproportionately: they were more likely to have mortgages, had larger mortgages, and their relief was at a higher rate.

The poverty trap was serious in the mid-1970s. The family income supplement to top-up low earnings (introduced under Heath) was withdrawn at 50% of *gross* pay. Its effects were additional to other benefit tapers, income tax and National Insurance. So effective rates often exceeded 100%.[81] Labour's early reduction of real allowances aggravated the problem, as more benefit recipients paid tax: in 1976/77 the weekly tax-allowance for a married man with two young children was below his long-term supplementary benefit eligibility.[82] This might have made tax cuts look attractive. But they were not a cost-effective solution, as reduced rates and higher thresholds also benefited richer families. More efficient would have been reform of benefits (for example, assessing means tests on net instead of gross income, or reducing the taper-rate) which would have targeted help on the poorest. So, the poverty trap did not fully justify tax-cuts.

Influence

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[79] Fields, D. B. and Stanbury, W. T., "Income taxes and incentive to work: some additional empirical evidence", *American Economic Review*, Vol. 61, No.3 (1971), pp. 435-43.
[80] HM Treasury (1995), p. 1.23.
[81] *Ibid*, p. 8.4.
[82] Calculated from *Ibid*, p. 1.27 and p. 9.14.

Marginal rates featured little in the cabinet debates which turned the tide against tax-and-spend in 1975 and 1976. Shore recalls such arguments did not "have much resonance", while Rodgers cannot "remember any discussion [of marginal tax-rates] at all".[83] This reflected the Treasury's own disregard of the issue – officials doubted that unhappiness with high marginal-rates "translated into anything serious for the rest of the economy", as the labour of the highly paid was in fixed supply.[84]

Still, high marginal-rates were important in two ways. First, they contributed to the vague perception that tax had reached its limits. Although increases were possible without changing marginal rates, this was not obvious to non-Treasury ministers, leaving them less able to frame credible tax rises. Shore states:

> "we felt that there wasn't much one could do if [direct tax rises were] really to bite… We were up to 98% on the very rich, so not much more could be done."[85]

Secondly, as an economist at Number 10 recalls, "incentives, marginal rates and so on were intellectual justification" for tax-cuts that were already preferred.[86] In particular, they helped win the Labour Movement's acceptance of cuts. Concern with the poverty trap led the TUC to push for a lower starting tax-rate.[87] And union and Party concerns went beyond the bottom end: both approved a report that urged the adverse effects of high-marginal rates be reduced *at all levels*.[88] Indeed, the Party warned that Britain faced the "limits to the tolerable level of taxation…in terms of the marginal effect on increases in earnings" and argued this necessitated selective spending cuts.[89] Concern for marginal rates thus weakened the Movement's demands for higher tax-and-spend.

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[83] Interviews: Lord Shore and Lord Rodgers.
[84] Interview: Sir Douglas Wass.
[85] Interview: Lord Shore.
[86] Interview: Lord Lipsey.
[87] NEC Box LXVIII. Liaison Cttee: 21st Nov 1977.
[88] NEC Box LXVI. *The next three years and into the 1980s*. Approved by Liaison Committee on July 25th 1977, and by the HPC on 19th July 1977.

3.4 Market and IMF confidence

The Argument

In 1976, supporting the pound was essential. Exchange-rate theories imply this required altering market-expectations of macro-variables like inflation, the current account and interest rates.[90] In 1976 this meant a deflationary fiscal tightening.[91] But markets may have discriminated between means of closing the PSBR. If they believed in any of the mechanisms described in sections 3.1 to 3.3, they would have expected high tax-and-spend to worsen inflation or competitiveness, and so reduce Sterling's equilibrium value. Deflationary tax rises would then have to have been bigger than spending cuts to effect the same improvement in Sterling. Even misguided market opinion would then represent an additional pressure specifically for cuts. In December 1976 winning IMF, rather than market, confidence became the key. But in practice the IMF was concerned to win back market approval, and it may have ideologically preferred a smaller state. So in effect the same pressure continued.

Evaluation

Influential financial voices certainly argued against deflation by tax rises. The *Wall Street Journal* argued that only "by some mad twist of logic" could the 1975 Budget which raised "$3 billion in taxes on an economy already strangling on taxes" be called "brave". And its attack was in a manner to undermine confidence in Sterling:

> "The British government is now so clearly headed towards a policy of total confiscation that anyone who has any wealth left is discounting furiously [sic] to get it out of the country."[92]

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[89] NEC Box LXII. HPC: RE:509/March 1976; *The Economy and Public Spending*.

[90] For an overview of the theories see: Begg, D., "Floating Exchange Rates in Theory and Practice", *Oxford Review of Economic Policy* Vol. 5, No.3 (1989), pp. 24-40.

[91] This improved the current account and reduced the perceived risk of inflationary monetisation.

[92] *Wall Street Journal*, 29th April 1975; Quoted in Burk & Cairncross (1992), p. xiv.

But over 1975 as a whole depreciation was modest.[93] Indeed, in early 1976 the Treasury believed "a gentle depreciation was in order".[94] So, pressure on Sterling did not necessitate the February 1976 cuts. But in March the pound's great slide began, and from then on market-opinion did bear on tax-and-spend, as the deflationary July 1976 mini-Budget showed. It matched spending cuts of £1 billion with National Insurance increases of a further £1 billion to try and hold the pound. The latter was arguably counter-productive, as these tax rises "only underlined, in the eyes of overseas opinion and the financial markets, the Government's reluctance to cut public expenditure."[95] At a minimum the efficacy of the deflation was reduced, and the pound failed to rally.

International political opinion was also important, even from before the final cuts. Britain required IMF credit even in 1975, and in mid-1976 the US approved a BIS loan which was granted on the unusual condition of full repayment within six months.[96] They foresaw this would necessitate a conditional IMF loan: American Treasury Secretary Yeo admitted the US had "put up the money 'for the bait' – i.e. to hook the UK economy into IMF control".[97] So, it seems there was a US agenda, and it is likely that this included tax-and-spend cuts. The major influences on American foreign economic policy were all Right-wingers who regarded Labour's welfare policies as bankrupt. For example, Fed Chairman Burns described his approach to Britain as that of a "a Neanderthal conservative" who was "naturally suspicious of a Labour government".[98] And Yeo was "unimpressed" by the July measures,

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[93] Quarterly exchange rates in CSO (1982), p. 145.
[94] Healey, D. *The Time of My Life* (Penguin, 1990 ed), p. 426.
[95] Keegan, W. & Pennant-Rea, R., *Who Runs the Economy?* (Maurice Temple Smith, 1979), p. 164.
[96] See Burk and Cairncross (1992), chapters 1 and 2, for discussion of dealings with the IMF prior to the final autumn 1976 application. The narrative implies American opinion was decisive throughout.
[97] Young, H. and Fay, S., "The Day the £ Nearly Died", *The Sunday Times*, 14th May 1978, p. 38.
[98] *Ibid*, p. 38.

because "Britain's economic problems were not going to be solved by higher taxes".[99]

Although negotiation for the final loan was formally with the IMF, in practice American influence remained central, as at the IMF "predominant power was from the outset exercised by the US", its chief shareholder and geographical host.[100] Pliatzky, a mandarin involved in the negotiations, recalled the IMF's formal position:

> "It was conceded that it was for the British government to choose between the different ways of reducing the PSBR, but expenditure reduction would have a better effect than tax increases on financial opinion and on the economy."[101]

Thus if the official position is taken at face value, deflationary tax increases were possible but were considered less effective, and so presumably would have had to have been more draconian than cuts.

Influence

Healey recalls that in "1974 the Treasury…believed that exchange rates were mainly determined by a country's rate of inflation and balance of payments", but that soon afterwards it was realised they "depended largely on the economic fashions of the time".[102] One such 'fashion' was market distaste for the big state. Until mid-1976, the Treasury felt such market views "low on the agenda" in planning the method of deflation, and "in early 1976…the market reaction was not sufficiently evaluated", which encouraged the (ineffective) National Insurance increase in July 1976. Adverse market reaction to this meant that attitudes changed, and "market factors did loom larger in the choice" between tax rises and spending cuts, so that by December 1976 confidence was a clear reason to prefer cuts.[103]

[99] *Ibid*, p. 35.
[100] Burk and Cairncross (1992), p. 6.
[101] Pliatzky, L., *Getting and Spending* (Oxford: Basil Blackwell, Revised ed, 1984), p. 148.
[102] Healey (1990), pp. 412-13.
[103] Interview: Sir Douglas Wass.

Once IMF confidence was the immediate issue, Callaghan clearly perceived the political dimension: Britain could hope to secure better terms by threatening isolationism in trade and defence. He put great energy into international negotiation, stressing to President Ford that better terms were needed to avoid calling "into question Britain's role as an Alliance partner".[104] But reports of his dealings with Schmidt, Ford and IMF-director Witteveen all suggest his negotiations centred on the size of the deflation: there seems to have been no attempt to secure a free hand to increase tax.[105]

Within Cabinet, views differed about whether international confidence was a serious constraint. For Right-wingers, like Rodgers, confidence was the central economic reason to favour cuts over tax rises.[106] The Left, in contrast, saw it as something "we would have taken for granted", a problem to work around, not one to dictate policy.[107] Indeed, the Left's aim was to evade the confidence constraint by exchange-controls. But as pressure on the pound intensified, more came to see it as a binding constraint. Thus Crosland, who in late 1975 urged ministers not to be "too timid to resist talk of the pound and international confidence", and had resisted the argument even in July 1976, was by the time of the IMF crisis admitting that: "The only serious argument for cuts was one in terms of international confidence".[108]

The Movement never saw confidence as a constraint. The Party tended to believe that creditors who looked unkindly on its policy should be informed that they were wrong. Thus Hart received rapturous reception when she told Conference that:

> "If Jim and Denis are worried about foreign confidence and the run on the pound, let them tell the IMF that we don't agree with the pre-Keynesian economics that dominate the IMF."[109]

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[104] Transcript of Callaghan's conversation with Ford, in Callaghan, J., *Time and Chance* (Collins, 1987), p. 430.
[105] For details of the international negotiations see Morgan, K. O., *Callaghan* (Oxford: Oxford University Press, 1996), pp. 538–48, *passim*.
[106] Interview: Lord Rodgers.
[107] Interview: Lord Shore.
[108] Crosland, S., *Tony Crosland* (Jonathan Cape: 1982), p. 307 (1975); p. 343 (July 1976) and p. 377 (November 1976).
[109] Quoted in: Jones, M., *Michael Foot* (Gollancz, paperback ed., 1995), p. 401.

The Party's indifference to market-opinion was very clear in its repeated insistence that the fiscal stance be assessed on a revised basis so that nationalisation had no bearing – the market's inevitable objection to this view was simply not considered.[110] Indeed, in December 1976 it became clear that asset transfers did affect confidence when a large part of the 'fiscal tightening' that saved the pound was delivered by asset sale.[111] Yet the Party retained its preferred methodology as late as 1978.[112] This dogged refusal to contemplate market reaction to fiscal policy ruled it out as an argument to win the Party over to cuts in tax-and-spend.

3.5 Conclusion

The supposed *structural* limits on extending social democracy in the 1970s – resource crowding-out, equilibrium inflation and marginal tax-rates – were unimportant, both 'objectively' and in their influence on policy. They were, however, important in rationalising decisions *already* taken, and in winning the Movement over to lower tax-and-spend. Constraints specific to the macroeconomic environment – confidence and the inflationary spiral – were genuinely important. They also weighed with Cabinet – especially inflation in the autumn 1975 debates, and 'confidence' in December 1976.

[110] See, for example, NEC Box LX. RE:231/July 1975, *Economic Report*; discussed at HPC 7th July 1975.
[111] See: the 1976 "Letter of Intent", clause 12; reproduced in Burk and Cairncross (1992), pp. 229-36.
[112] Alternative methodology deployed, for example, in Proposals in NEC Box LXVIII. HPC RE:1499/Feb1978, *Economic Report and Budget Proposals*, *Spring 1978*, p. 28.

4: Public Opinion

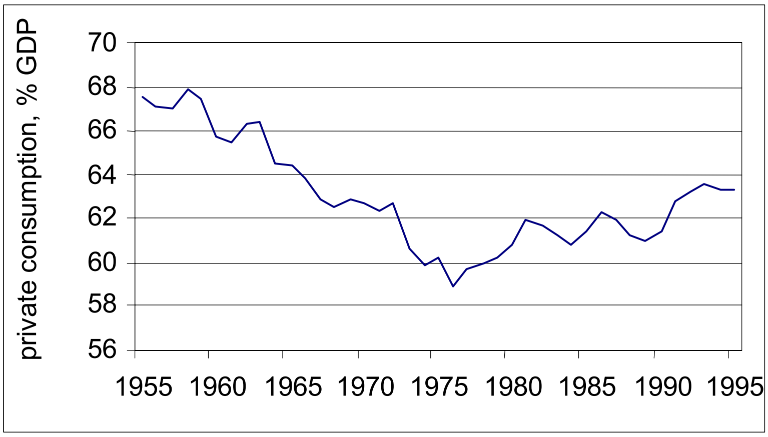
Electoral pressure might have motivated the government to abandon social democracy even if it remained economically viable. A global 'tax revolt' in the 1970s and 1980s has indeed been described – cited in its support are the 1978 Californian referendum which legally capped tax-rates, and the world-wide success of tax-cutting politicians, like Reagan and Thatcher in the succeeding few years.[113] This chapter argues that there was reason to expect anti-social-democratic opinion in 1970s Britain. It then assesses evidence for it, and asks whether the government was influenced by the perception that the public mood had changed.

4.1 Were Electoral Constraints to be Expected?

'The Crisis of Consumption'

The real counterpart of expanding government in the long-term was squeezed privately financed consumption (not, as Bacon and Eltis feared, investment). Figure 4.1 shows its fall from 67.5% to 58.9% of GDP over

Figure 4.1: Consumers' Expenditure in GDP[114]



1955-76. Subsequently, as the state contracted, the consumption-share grew, returning to mid-1960s levels in the 1990s. The long-term reduction in the

[113] Kay, J. & King, M., *The British Tax System* (Oxford: Oxford University Press, 5th ed., 1990), p. 219.

share of national income consumed might be expected to have provoked tax resistance.

After 1974 stagnant national income exacerbated the implications of consumption's longstanding relative squeeze. The combined result was cumulative falls in real personal incomes of 4.0% and of 2.6% in consumption spending in Labour's first four years, as Table 4.1 shows. The *assumption* of growing prosperity would have heightened the political impact: incomes and consumption had hitherto increased every year since 1952, bar a minor decline in consumption in 1965. [115] In these circumstances support for lower tax-and-spend to allow higher consumption seems highly feasible.

Table 4.1 – Real Incomes and Spending under Labour[116]

Year	Real disposable income (1975 £ billion)	Real consumers' expenditure (1975 £ billion)
1973	75.3	66.3
1974	74.2	65.1
1975	73.9	64.7
1976	73.4	64.8
1977	72.3	64.6
1978	78.4	68.2
1979	83.7	71.4

Support for Redistribution

Alesina and Rodrik (1994) argue low (gross-income) inequality makes redistribution less likely. The median self-interested voter supports less redistribution with lower inequality, providing (as typically) mean-income exceeds the median.[117] Assuming the median-voter hypothesis – that vote-maximising governments follow the preferences of the median voter on the

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[114] Post-1965 figures calculated from: CSO (various years); pre-1965 calculated from: Feinstein (1976).
[115] CSO (1982), p. 20.
[116] *Ibid*, p. 20.
[117] Alesina, A. and Rodrik, D. "Distributive politics and Economic Growth", *Quarterly Journal of Economics*, Vol. 109, No. 2 (1994), pp. 465–90.

ideological spectrum – then less redistribution follows.[118] Figure 2.5 showed 1977 saw inequality at a record low. This largely reflected gross-incomes.[119] Thus Alesina and Rodrik imply public opinion may have led the government to support a smaller state doing less redistribution in the mid-1970s.

4.2 Opinion Poll Evidence

Before 1978 pollsters tested support for tax-and-spend only occasionally. Table 4.2 offers two 'snapshots' taken in each of three different eras. Systematic bias is possible (e.g. if social pressures leave respondents exaggerating their willingness to pay tax), so how reported attitudes 'cash-in' in voting terms is unclear. Nonetheless change over time is significant, and the late 1970s saw opinion unusually anti-statist: only a minority backed tax-financed spending increases, whereas in both the later and earlier period this was the majority view. Regular results since 1978 suggest that 1979 itself was the turning point: by 1981 the majority for spending increases returned, it has since trended upwards and been continuous.[120]

Table 4.3 shows attitudes to redistribution across elections. The first and third questions concern spending on the needy, and their contrasting absolute results show the importance of question-framing. But again, it is trends that matter, and over 1974-79 there was anti-egalitarian movement. The majority against higher benefits rose 11 percentage-points, while the fraction believing benefits were already excessive increased sharply, to 50%. The majority for anti-poverty spending also dropped, by 7 points. But by 1983 both trends were in reverse: most notably support for the view that current benefits were excessive fell 16 points. So, it seems the mid-1970s saw a transitory low-point

[118] The median-voter hypothesis assumes vote-maximising politicians, rational choice in voting and that voters may be placed on a left-right spectrum where they collectively exhibit mono-modal preferences. The requirement that views be ranked on a spectrum has been criticised as requiring adoption of an implausible one-dimensional framework. But views on the desirable extent of redistribution are perhaps unusually well suited to quantification, and so ranking. The theory first emerged in: Downs, A., *An economic theory of democracy* (New York: Harper and Row, 1957).
[119] Goodman et al (1997).
[120] Kellner, P., "What does the public think?", in Corry, D. (ed.) *Public Expenditure* (The Dryden Press, 1997). Table of results, p. 125.

in support for redistribution, rather than representing a permanent sea-change against it.

Table 4.2 – The Preferred Balance between Tax and Spending[121]

Date	Prefer both tax and spending cuts **(a)**	Keep current tax and spend levels **(b)**	Prefer both tax and spending increases **(c)**	Majority for spending increases **(a) - (b) - (c)**
High post-war consensus				
Jan 1959	13%	9%	78%	+ 56%
May 1960	28%	5%	67%	+ 34%
Late 1970s				
Oct 1978	29%	26%	45%	- 10%
May 1979	37%	26%	37%	- 26%
Post-Thatcher				
July 1993	8%	15%	75%	+ 52%
Feb 1995	8%	16%	69%	+ 45%

Even this conclusion is diluted by the table's second question. Support for general "redistribution" did not decline significantly over 1974-79: change was negative, but the pro-redistribution majority dropped only 2 points, within the poll's (95% level) margin of error, and in 1979, 51% still favoured redistribution. Thus claims that the late 1970s saw a strong, cohesive anti-social-democratic mood seem dubious.

Table 4.3: Support for Redistributive Policies[122]

Date	**Support (a)**	**Indifferent (b)**	**Opposed (c)**	**Egalitarian Majority (a) - (b) - (c)**

[121] Source: Gallup Political Index (various editions). The earliest entries are for slightly different questions. In 1959: "If the Chancellor discovered that he had a surplus should he spend it on health, pensions or other services or use it for tax cuts?"; in 1960: "Would you prefer more spending on services, such as pensions the NHS, *etc.*, or tax cuts". Those failing to express a preference have been counted here as wanting to keep current tax-and-spend levels. Since 1978 the respondents have been offered a choice between: "tax cuts, even if it meant some reductions in services like health, education and welfare"; "keeping things as they are"; or, "increased spending on services like health, education and welfare even if that meant some increases in tax".

[122] Crewe, I., Fox, A. and Day, N., *The British electorate, 1963-92* (Cambridge: Cambridge University Press, 1995), p. 379.

Govt Spending to get rid of poverty				
Oct 1974	87%	6%	7%	+74%
May 1979	84%	8%	9%	+67%
May 1983	86%	3%	11%	+72%
Redistribution of Income and Wealth				
Oct 1974	56%	16%	28%	+12%
May 1979	55%	17%	28%	+10%
May 1983	48%	15%	37%	-4%
Welfare benefits now…				
	Do not go far enough	**Are about right**	**Have gone too far**	
Oct 1974	23%	43%	34%	-54%
May 1979	17%	32%	50%	-65%
May 1983	29%	51%	20%	-42%

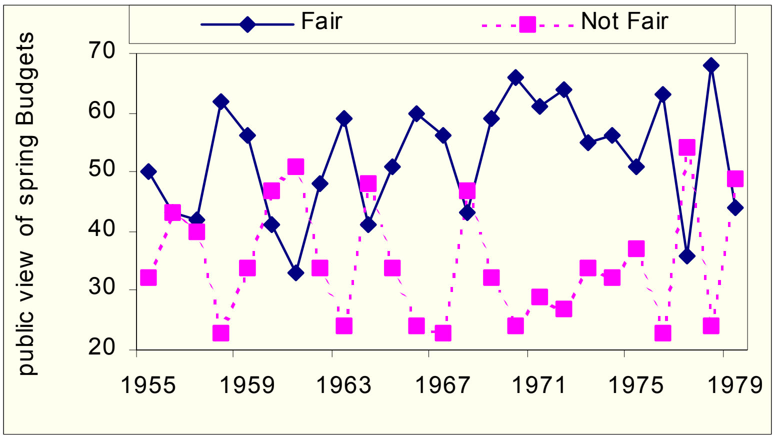
We have tentatively established that opinion moved against social democracy in the years approaching the late 1970s. But a more detailed picture of change over time is needed before its significance is known. In particular, did public opinion change precede policy changes, or did the public follow the government's lead? And, how determined and consistent were the changes?

After each Budget pollsters ask whether it was "fair". Budgets whose fiscal stance allowed an overall giveaway are likely to be judged fairer, but a long-run upward trend towards viewing budgets as "unfair" should be expected if the country was coming to think its tax burden excessive. Figure 4.2, however, shows there was no such trend. This casts doubt on the idea the public was growing consistently more tax-resistant in years to the mid-1970s.

Neither do responses to individual Budgets suggest strong anti-statism. Most voters deemed Labour's early tax increases fair – the 1974 Budget was endorsed more strongly even than the tax-cutting giveaway 1973 Budget. 1975's tax rises were less popular, but the modest slippage can be explained by the tighter fiscal stance in 1975, and it still commanded majority support. Reaction to the later tax-cutting Budgets was mixed: 1976 and 1978 were well received, but in 1977 a clear majority judged a tax-cutting Budget unfair. These inconsistent results suggest the public lacked a clearly defined view on tax-and-spend, but condemned the 1977 Budget as the government was generally unpopular (see below). Finally, the suggestion that the public had come to

oppose progressive redistribution is challenged by the hostile reception to Howe's regressive 1979 budget.

Figure 4.2: Public Views on 'Fairness' of the Budget, 1955-79[123]



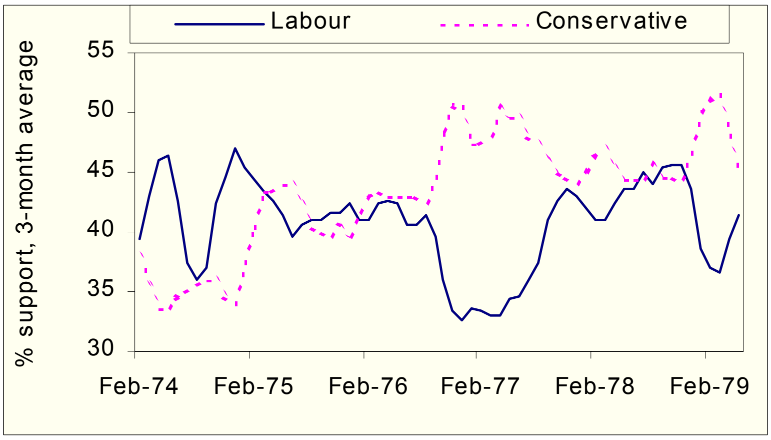
A party's support reflects public attitudes to a range of its policies, and also its perceived general competence. But as Thatcher campaigned so forthrightly to cut tax-and-spend from 1975 onwards, if opinion shifted strongly against statism, then persistent growth in Conservative support might be expected. Figure 4.3 shows voting-intentions over the government's life. A 3-month moving average is used as the raw figures' (+/-3%) margin of error produces illusory volatility.

The path to the 1979 Conservative victory suggests opinion on tax-and-spend was unimportant. As late as September 1976, the parties' standing was equal. So, Labour's early decisions to cut tax-and-spend *preceded* its unpopularity. Only as the IMF crisis broke did Conservative support grow strongly. This probably reflected the currency crisis's erosion of perceived government competence: Wilson and Major's governments (respectively in 1967 and 1992) suffered comparable collapses after Sterling crises.[124] Further, the swing reversed in 1977: the parties were again equal in mid-1978. If radical tax-and-spend cuts were sought, voters would surely have backed the

[123] Gallup political index (various editions).

Conservatives more consistently. Finally, timing of the decisive pro-Tory swing again suggests perceived competence rather than ideology was responsible: it occurred when the 1978-79 strikes again made the government look incapable.

Figure 4.3: Support for the Main Parties under Labour[125]



Overall, as expected, late 1970s opinion seems to have been unusually anti-social-democratic, but its significance for policy is questionable. First, there is no evidence of a persistent sea-change, so insofar as it represented a limit on social democracy it was so only in a short-term sense: it cannot explain the long-run policy reversals since the 1970s. Secondly, it cannot fully rationalise even the mid-1970s cuts, as government unpopularity onset only after these had started. Finally, if voting behaviour reflected complex interaction between parties and electors, rather than simple rational choice, government unpopularity could have caused anti-social-democratic sentiment rather than the reverse. Psychologically, *cognitive dissonance* might have led individuals to adopt anti-social-democratic views after they had converted to the Conservatives for other, non-ideological reasons.[126] Voters may have 'bought into' Tory anti-statist rhetoric rather than live with the discomfort of opposing it when they in any case intended to support the Party.

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[124] Gallup monthly poll complied in: Butler, D. and Butler, G., *British Political Facts, 1900 – 1994* (Macmillan, 7th edition, 1994). See p. 252 and 258.
[125] *Ibid*, pp. 254-55.

Even though it seems unlikely that shifting opinion initially enforced policy-reversals, once opinion moved it would have been an additional pressure against social democracy in the government's last years.

4.3 Government Perceptions

Healey told colleagues he was "The most political Chancellor you've ever had", and he certainly does seem to have been motivated to abandon tax-and-spend by electoral considerations.[127] In Cabinet he repeatedly demanded cuts on this basis. He argued publishing figures to show the public the value of their welfare provision would leave them "shocked, not pleased, when they saw how much we were spending on the social services": they already "felt too much of our national resources were going on the public services".[128] He claimed the February 1976 cuts would be popular, telling Cabinet:

> "At the Labour clubs you'll find there's an awful lot of support for this policy of cutting public expenditure. They will all tell you about Paddy Murphy up the street who's got eighteen children, has not worked for years, lives on unemployment benefit, has a colour television and goes to Majorca for his holidays."[129]

Other Right-wing ministers shared Healey's belief that cuts were politically attractive. Callaghan argued for the IMF cuts because they would allow tax reductions and "in this we can expect wide public support".[130] Likewise, Rodgers recalls fear of the electoral consequences of tax rises as being (along with confidence) the most important reason for choosing cuts as the means to deflate.[131]

The waning of the government's interest in redistribution was also partly politically motivated. Callaghan's advisor recalls that the post-1976 decision to cut income tax *rates*, rather than cutting tax more progressively through higher allowances, was political:

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[126] Festinger, Leon, *A Theory of Cognitive Dissonance* (Tavistock Publications, 2nd ed., 1962).
[127] Castle (1990), p. 641, August 4th 1975.
[128] *Ibid*, p. 634, July 14th 1975.
[129] Benn (1989), p. 461, 13th November 1975.
[130] *Ibid*, p. 672, 2nd December 1976.
[131] Interview: Lord Rodgers.

> "I remember…trying to explain this to the Prime Minister [the advantages of increasing allowances]. And he was being more obtuse about it than his mental equipment made likely. And I have no doubt why, he didn't want to believe that that was effective as there were more votes and headlines in income tax-rates as people didn't understand thresholds."[132]

Even Crosland, social democracy's high-priest, was influenced by the view that:

> "you could not afford to put all your eggs in the public expenditure basket – because that did not deliver a reasonable level of real increase in living standards for working people and you wouldn't win elections."[133]

But perceptions of this 'electoral constraint' varied hugely with ministers' own ideological orientation: the Left was sceptical. Benn doubted the voters that Healey caricatured would vote Labour in any circumstances.[134] Even where statist ministers felt tax-and-spend cuts would be popular, they refused to believe this should dictate policy. Shore emphatically insists that the electoral effect of taxing middle-income families "wouldn't have worried us".[135] While Crosland saw that a swing to the Right made cuts politically easier than in the 1960s, he did not conclude this made them attractive or necessary.[136] Indeed, he continued to fight against them.

4.4 Conclusions

In the late 1970s voters' attitudes were atypically anti-social-democratic, but the delayed and inconsistent nature of the evolution of these views calls into question their power as a constraint. Within government, the Right certainly believed that the public was demanding tax-and-spend cuts, but its ability to affect cabinet decisions was weakened because other factions interpreted opinion differently, and in any case believed in holding firm.

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[132] Interview: Lord Lipsey.
[133] Interview: Lord Lipsey.
[134] Benn (1989), p. 461, 13th November 1975.
[135] Interview: Lord Shore.
[136] Crosland (1982), p. 390.

5: Ideational Developments

Chapters 3 and 4 suggested the important pressures against state expansion in the late 1970s were short-term – they cannot explain why, as Chapter 2 showed, social-democratic trends were enduringly broken. The significance of the 1974-79 reversals thus crucially depends on whether exogenous pressures alone explain them. If so, the endurance of anti-social-democratic policies since then reflects the Conservatives' 1979-97 dominance. But if instead the reversal was partly an act of Labour will, the late 1970s have more significance, as even without Mrs Thatcher, ideational changes might have forced social democracy into long-term retreat.

This chapter assesses the role played by the autonomous evolution of Labour thinking in the policy reversals. It maps out the unfavourable intellectual context social democracy faced in mid-1970s before tracing the evolution of thought within Labour's various factions.

5.1 Context: Social Democracy under Pressure

'Butskellist' 1950s policy made social democracy – demand-management and expanding welfare – near-consensual.[137] This reflected perceived success as the economy outperformed interwar precedent. But by 1960, awareness developed that Britain's growth lagged its competitors'.[138] Butskellism's problems strained social-democratic self-confidence: Crosland warned he had earlier been "too optimistic …about the performance of Anglo-Saxon economies".[139] Yet in practice the initial response was to extend statism where Butskellism had remained *laissez-faire*. 1961 saw the 'pay pause', which initiated government encroachment on wage bargaining, and the founding of the NEDC, which signalled a new macroeconomic corporatism. Labour argued government should do still more, looking admiringly to continental indicative

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[137] "Butskellism" derives from a journalist who argued continuity between Labour and Tory policy meant the economy was effectively run by "Mr *Butskell*…a composite of the present Chancellor and the previous one". Article in *The Economist* referring to R. Butler and H. Gaitskell, 13th February 1954.

[138] Comparative international growth figures shown in Tomlinson, J., "Britain", in Schulze, M. S. (ed.), *Western Europe* (Longman, 1999), p. 270, Table 16.1.

plans. In office from 1964, it announced a *National Plan*. As early as 1967, though, low growth made its failure transparent.

At this point the debate started to polarise. On the Right, inflation encouraged Friedman and others to promote rediscovery of market virtues over Keynes. Simultaneously, American New Rightists invented 'government failure'. Niskanen dismissed traditional ideas of public service and substituted the rent-seeking bureaucrat. His 'budget-maximisation' resembled profit-maximisation, but unlike private managers he lacked competition and so was wasteful. Thus built-in mechanisms of expansion left the state inefficiently over-sized.[140] These ideas had influence beyond the academy. The 1970 Conservative manifesto broke post-1945 precedent in being explicitly anti-social-democratic: "there has been too much government: there will be less".[141]

Meanwhile, a socialist Left argued social democracy was flawed as capitalism would not sustain further incremental improvements without fundamental change. Holland argued multinationals undermined Keynesian and regulatory policies. State influence over employment, prices and investment would fail as managers escaped national control. Thus, "without public ownership of the means of production, distribution and exchange, the state will never manage the strategic features of the economy in the public interest."[142] More generally the New Left argued declining profits signalled a Marxian crisis of capitalism, necessitating a choice between moving "forward to socialism or back to the market". The Labour Left was heavily influenced, in particular believing compulsory industrial policies were required. These figured prominently in Labour's (otherwise social-democratic) 1974 platform.[143]

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[139] Crosland, C. A. R., *The Future of Socialism* (Jonathan Cape, revised ed., 1964), preface.
[140] Niskanen, W., *Bureaucracy and Representative Government* (Chicago: Aldine Press, 1971).
[141] "A better tomorrow" (The Conservative Party, 1970), p. 118.
[142] Quote from Holland, S., *The Challenge of Socialism* (Quartet, 1975), p. 15. Also influential was his: *The State as Entrepreneur* (Weidenfeld & Nicholson, 1972).
[143] The Labour Party (1974a) and (1974b). See in particular: p. 191 and p. 245.

During 1974–79, as social democracy struggled with stagflation, new political charges were levelled alongside economic criticism. The newly confident Right looked back to Hayek who had argued:

> "Once the communal…sector exceeds a certain fraction of the total the effects of its actions dominate the whole system."[144]

He held such domination undermined liberty, the plural society and good government. In the mid-1970s the argument's resonance strengthened as inaccurate official figures suggested that the state represented 60% of national income (the real figure was just above 45%).[145] Dell recalled the 60% figure as "one to strike horror into the most valiant social-democratic heart".[146] It was certainly one to encourage Hayekian arguments about Britain.

King held Britain risked 'ungovernability' as "the number of dependency relationships which the government is involved has increased substantially", giving it an unmanageably vast remit.[147] Brittan argued the 'electoral market' generated excessive tax and borrowing. Parties were forced to outspend each other because information-costs denied voters a budget-constraint: public expenditure's costs were obscured while its benefits were transparent.[148] Others argued from this supposed informational asymmetry that the big state was "politically bankrupt" – fully informed assent to its growth had never been given. Consequently, disillusioned citizens would no longer voluntarily co-operate with government, making more compulsion necessary.[149] The argument implied liberals should resist state expansion to avoid this commensurate compulsion.[150]

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[144] Hayek, F.A., *The Road to Serfdom* (Routledge and Keegan-Paul, 1944), p. 61.

[145] Pliatzky, L., *Getting and Spending* (Oxford: Blackwell, 2nd ed., 1984), pp. 156–63 describes the errors. The most important was the inconsistency arising from assessing GDP at factor cost, but public spending at market prices.

[146] Dell (1991), pp. 185-86.

[147] King, A. (ed.), *Why Britain is becoming harder to govern* (BBC, 1976), pp. 18-19.

[148] Brittan, S., *The economic consequences of democracy* (Maurice Temple Smith, 1977), p. 266.

[149] Rose, R. and Peters, G., *Can government make a difference?* (Macmillan, 1979), p. 34.

[150] The aim here is not to evaluate these theories, but contrast with the work of earlier pluralists shows how the *ad hoc* assumptions of such 'social-science' moves with intellectual fashion. In the social-democratic world of the 1960s Downs assumed information-costs that

5.2 Healey, Callaghan and the Right

In 1974 Labour was already an uneasy alliance. But the party gained cohesion from support of tax-and-spend. Even one of the most Right-wing ministers admits:

> "The party [of 1974] had, as one common objective, substantially enhanced social provision. Economic policy was seen as making its contribution through taxing wealth."[151]

By 1979 this had changed. Vast cuts had been made, yet Callaghan's closest advisor judges that even if Number 10 had been free from exogenous pressure, "we wouldn't have reversed the scale or direction of the cuts."[152] More generally, Labour's Right ceased to believe that Labour had necessarily "to spend more than our predecessors": it had abandoned high tax-and-spend as an article of faith even for the long run.[153]

The Right never desired spending growth as rapid as during 1974/75. This followed by default, first, because of the inevitable second 1974 election. Before this the Cabinet never strategically discussed spending.[154] Instead, new spending uncovered by tax was approved to secure victory. Secondly, in early 1975, winning a "yes" in the European referendum was the Right's priority. Wilson's 'nightmare' was that the referendum would destroy Labour by pitting leaders against the (largely anti-EEC) movement.[155] Avoiding this required a non-confrontational approach to spending (amongst other issues) before the vote: Wilson let the pro-spending majority prevail against Healey's demands so that by mid-1975 Foot believed cuts were defeated.[156] But immediately after the vote Wilson moved rapidly to exploit victory by preparing the ground for the autumn 1975 cuts debate.

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prevented knowledge of the *benefits* of public spending to explain "Why the Government Budget is too small in a Democracy". In Phelps, E. (ed.), *Private Wants and Public Needs* (New York: W. W. Norton, 1965), pp. 76-95.

[151] Dell (1991), p. 13.

[152] Interview: Lord Donoughue.

[153] Interview: Lord Rodgers.

[154] Donoughue, B., *Prime Minister* (Jonathan Cape, 1987), p. 51.

[155] Pimlott, B., *Harold Wilson* (Harper & Collins, 1992), p. 654.

[156] Castle (1990), p. 635, 17th July 1975.

In early 1976 signs emerged that some Right-wingers aimed to do more than slow the growth of government to a 'sensible' rate: rather, they wanted *less* tax-and-spend. Jenkins's Anglesey speech sounded Hayekian alarm at the (incorrect) figures putting public spending at 60% of GDP:

> "I do not think that you can push public expenditure above 60% and maintain the values of a plural society with adequate freedom of choice. We are here close to one of the frontiers of social democracy."[157]

Rodgers recalls that when Jenkins suggested "that even 50% was too high", then "he spoke for us all [the future SDP] in that respect."[158]

Over 1976, this ideational change became more widespread. In February 1976, Right-wing ministers effectively argued the opposite of Galbraith to the unions: that social provision amounted to public affluence next to pressing private needs. Williams argued much public spending represented waste, while Mulley insisted education cuts were acceptable as employment was high in the sector.[159] Callaghan's personal interventions, after his installation as PM in April 1976, show he saw privately financed consumption as priority. For example, he stalled the replacement of child tax allowances with child benefit, which went straight to the mother, as he was concerned about diverting resources from the pay packet.[160]

In the IMF debates the extent and the depth of the Right's conversion become clear. Some Right ministers, like Lever, initially criticised cuts as deflationary. But Healey only had to promise that any "overkill" on spending would enable tax cuts to dispose of this resistance, as these critics were indifferent to the level of tax-and-spend.[161] Meanwhile, other Right-wingers positively welcomed the crisis as providing political cover for reducing tax-and-spend. Mason thought cabinet should make a virtue of its predicament and

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[157] Speech made in Anglesey, 23rd January 1976. Quoted in Mullard (1987), p. 6.
[158] Interview: Lord Rodgers.
[159] NEC Box LXII. Liaison Cttee: 26th February 1976.
[160] Healey (1990), p. 448.
[161] Benn (1989), pp. 668-69, 2nd December 1976.

"rally round the tax cuts" that would follow. Morris preferred "generous" to "grudging" IMF approval as this would secure "lower taxes". [162]

Underlying the Right's abandonment of statism was their rejection of what had earlier been its chief rationale, egalitarianism. Many favoured the higher inequality that would follow lower tax-and-spend. Morris, for example, hoped that tax cuts would extend beyond "our people" to:

> "Middle managers …[who] were 'cabin'd, cribb'd and confin'd bound in' by the present tax levels and the incomes policy squeeze."[163]

Inegalitarianism also saw progressive tax rises opposed. Healey moved against Labour's proposed wealth tax, which had symbolic importance in signalling that a bigger state should erode the privileges of wealth. In autumn 1975, Healey insisted he remained firmly committed.[164] Yet a year later he objected even to a working-group to consider it. He bemoaned the difficulty of a "workable scheme", but as the working-group was to examine just this problem, it seems likely that his objection was more than practical.[165] Likewise, in 1977 Callaghan resisted proposals for gradual cuts to mortgage tax-relief for those at the top of the income distribution.[166]

The Right's loss of enthusiasm for redistributive tax-and-spend was clear in their IMF crisis proposal for benefit cuts. Opinion moved rapidly on this. In allocating the July 1976 cuts, Callaghan suggested to Cabinet (which made no recorded objection) that "we exclude making cuts in social security benefits."[167] Yet in December 1976 he held up benefits being "reduced in a way that would be sensible" as a positive advantage of settling on the IMF's terms.[168] Partly this reflected new concern with 'replacement-rates' – the Right believed inequality between the lower-paid and the workless was insufficient to make work pay. Thus Williams argued for tax cuts bigger than macro-

[162] *Ibid*, p. 671, 2nd December 1976.
[163] *Ibid*, p. 671, 2nd December 1976.
[164] NEC Box LXI. Liaison Cttee: November 24th 1975.
[165] NEC Box LXIV. Liaison Ctte 43: December 6th 1976.
[166] Healey (1990), p. 449.
[167] Benn (1989), p. 596, July 15th 1976.
[168] *Ibid*, p. 673, 2nd December 1976.

economically required to allow "for an increase in the income tax threshold" to redistribute in favour of those in work and recognise "concern about the relationship of short-term benefits to take-home pay."[169]

Replacement-rates were only relevant to unemployment benefits, yet the Right also wanted to cut pensions, revealing more general inegalitarianism. The pensions 'earnings ratchet' pledged continuous growth in spending on one key low-income group, making it the central social-democratic policy in the 1974 manifesto. Yet by late 1976 Healey argued that to guarantee higher pensions was wrong when "worker's earnings were not protected".[170] Callaghan agreed: pensioners had recently received a relative increase, "but that can't go on that basis".[171] Yet the 1974 commitment was deliberately to continuous growth in the state's redistributive operation on precisely this basis: opinion had certainly changed.

Overall, the Right abandoned social democracy and replaced it with managerialism, rather than an alternative progressive ideology. In 1977, a journalist suggested to several ministers (mostly future SDP members, including Owen, Williams, Rodgers and Dell) that Labour now offered nothing more than a Conservative-style promise of competence. None resisted the suggestion. One admitted the passing of Croslandism but "confessed that a new philosophy was not available from the Labour revisionists. What distinguished Labour from the Conservatives he could best define as a 'feeling'."[172] This neatly sums up the post-ideological position of the Labour Right in these years: it might now be called 'Blairite'.

5.3 The Left and the Extra-Parliamentary Party

The Left identified itself by its support for the AES, rather than by its attitude to tax-and-spend. The AES aimed chiefly at avoiding deflation, and so unemployment. It centred on (physical) import controls to remove the balance-

[169] NEC Box LXIV. Liaison Cttee: 6th December 1976.
[170] Benn (1989), pp. 668-69, 1st December 1976.
[171] *Ibid*, p. 672, 2nd December 1976.
[172] Cole (1995), p. 166.

of-payments constraint. These necessitated "rationing and allocation" of imports. Other steps to socialise the economy were also envisaged: price-control; "control of banks and other financial institutions"; "work sharing arrangements"; and, more state industrial involvement.[173] As the Left believed the AES would avoid the choice between tax rises and spending cuts, this was relegated to secondary status, and the faction exhibited inconsistent views on the matter.

Left-leaning ministers included Foot, Shore and Benn.[174] In Cabinet, they did suggest tax rises were a lesser evil than spending cuts. For example, in autumn 1975, Benn urged the PSBR be partly reduced "by tax reliefs or tax changes".[175] In December 1976, Shore recognised the need for some deficit reduction, but felt "he would prefer taxation mainly".[176] Yet this was secondary: Shore recalls his preference for tax over spending "was not central to my beliefs at the time, like the unemployment issue."[177] And Benn separated the Left, which felt the government "should have a different economic strategy", from those who merely argued it "should raise taxation".[178]

As tax-and-spend was not a central Left principle, when consumption bottomed out in 1977 the Cabinet Left abandoned support for it in the short-term: Benn felt tax cuts temporarily "justifiable".[179] Its secondary status also meant Benn could work closely with the increasingly Left-dominated extra-Parliamentary Party (hereafter 'the Party'), even though it did not share his enthusiasm for higher tax-and-spend. The HPC represented the Party. It was chaired by Benn, but most of its members were senior Left figures outside government. From early 1975, the HPC commissioned reports explicitly to

[173] Note for Cabinet : "The Alternative Economic Strategy in Outline", in Benn (1989), pp. 726-27.
[174] Castle adopted the AES after leaving government, but it was never her priority.
[175] Benn (1989), p. 479, 11th December 1975.
[176] *Ibid*, p. 677, 2nd December 1976.
[177] Interview: Lord Shore.
[178] Benn (1989), p. 583, 21st June 1976.
[179] NEC Box LXVI. Liaison Cttee: 24th Oct 1977.

provide an "alternative to the conventional Treasury approach".[180] But on tax-and-spend the reports suggest the Party's attitude was remarkably close to Healey's.

The Party actually turned against tax rises *earlier* than the Chancellor. In Spring 1975, Healey added 2% to the basic rate of tax, but as early as February, the HPC argued against policies that would take the basic-rate to "unprecedented levels".[181] Its specific proposals for the 1975 Budget urged far smaller tax rises than the government implemented.[182] It also endorsed spending cuts before the government – to avoid "unacceptable increases in taxation" which would mean "squeezing consumers' expenditure intolerably hard".[183] So, the mid-1970s Party did not prioritise public over privately financed consumption.

Once cuts began, the Party opposed them on macro-grounds, but on tax-and-spend remained cautious. The state's growing GDP share implied there were "limits to the extent to which public expenditure can grow", especially as "the benefits" of high spending had "not always been apparent".[184] Again, while IMF conditions on trade were bitterly resented, its fiscal demands were accepted: cuts to reduce "the share of national resources taken by public expenditure" were "past history", and the Party "raise[d] no objection" to reducing the direct tax burden.[185]

Furthermore, in 1976 the Party came to recognise that "the real constraint on public expenditure" lay "in the tolerable limits of the tax burden", and it highlighted how this recognition affected spending more severely than other arguments for cuts. First, it meant the need for cuts was structural, not

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[180] Secretary Bish, outlining the aims of *Economic Outlook*. NEC Box LIX. HPC: 10th February 1975.
[181] NEC Box LIX. HPC: 10th February 1975, *Economic Outlook.*
[182] NEC Box LIX. HPC: 10th March 1975, *Economic Outlook.*
[183] NEC Box LX. HPC RE:231/July 1975, *Economic Outlook.*
[184] NEC Box LXII. HPC RE:509/March 1976, *The Economy and Public Spending.*
[185] NEC Box LXV. HPC RE:1006/March 1977, *Economic Outlook.*

cyclical. Secondly, it affected transfer spending, not just government consumption.[186]

Unlike the Right, the Left's ambivalence to statism emerged alongside continued egalitarianism. The Left united against benefit cuts. Orme reminded Cabinet they involved attacking the poorest: "We talk about the people on benefits – what are they actually getting?… A married couple with two children gets £27 at present compared to the average wage of £70 per week."[187] The Party, meanwhile, advanced only progressive cuts. Much spending, like higher education, was reducible as it was "scarcely progressive at all". Indeed, rail subsides were so "regressive" that they judged: "it may well make sense to phase [them] out." [Original emphasis].[188] And while opposing overall tax hikes through 1976, the HPC continued to demand progressive rises to finance reductions at the bottom end. In particular, it amended a report to insist on a £500 higher-rate threshold cut.[189]

In the specific circumstances of 1977, the Party's concern for squeezed consumption meant that it abandoned demands even for progressive tax rises. High-income gainers from Party tax proposals were now judged unproblematic: "it would be a mistake to worry too much about the benefit of increased tax thresholds seeping through" even to the highest-paid because the pay-policy had already squeezed them.[190] Similarly, faced with proposals for progressive restrictions on mortgage-relief, most "Left wing ministers kept their mouths shut".[191] But these were temporary changes, specific to 1977. In 1978, the Party again stressed the importance of targeting tax cuts, explicitly opposing a basic rate cut which "would give the greatest benefit to those higher

[186] NEC Box LXII. HPC RE:509/March 1976, *The Economy and Public Spending*.
[187] Benn (1989), p. 675, 2nd December 1976.
[188] NEC Box LXII. HPC RE:509/March 1976, *The Economy and Public Spending*.
[189] Original office report - NEC Box LXI. HPC RE:409/Jan 1976; *Costing Labour's Programme* - ruled out cutting the higher-rate threshold. But HPC objections led to its inclusion in: NEC Box LXII. HPC RE:514/March 1976, *Economic Report and Budget Proposals*.
[190] NEC Box LXV. RE:1006/March 1977, *Economic Outlook*.
[191] Healey (1990), p. 449.

up the scale".[192] So there had been no ideological conversion from egalitarianism.

But overall, in spite of continued egalitarianism, the Left failed consistently to defend tax-and-spend. Left ministers abandoned it as a short-term strategy after 1976, while the Party ceased to favour it even for the long-term. The failure to prioritise social spending did not just reflect the short-term consumption squeeze, but also, and more fundamentally, the Left's adoption of a non social-democratic viewpoint that saw welfare as secondary.

The focus was instead on the AES and industrial policy. Thus even when the Party proposed spending increases, the bulk was earmarked for the NEB and asset acquisition.[193] Likewise, Benn felt NSO revenue should be used to "re-industrialise", not for welfare.[194] Industrial policy's priority reflected many things – the Marxian perception that it alone could solve capitalism's crisis; the ideological appeal of the extensive socialisation it implied; and, the belief that cutting unemployment was the key to defending the working class. All this rendered welfare secondary, and anyone who prioritised it over the AES was mistrusted. When Castle suggested import-controls were irrelevant to saving spending, Benn wrote: "Barbara thinks socialism is about the social wage", which meant she would accept orthodox policies "if it would prevent public expenditure cuts in the DHSS". He concluded "she's not on our side at all, she's on the other side."[195]

5.4 The Unions and the Social-Democratic Centre

'Social democrats' are here classed as the residual group who consistently opposed cuts, but who opposed the AES or regarded it as secondary. They did not regard themselves as a group, as attitudes to non-spending issues and history divided them. Ten years earlier almost the whole

[192] NEC Box LXVIII. RE:1499/Feb, 1978: *Economic Report and Budget Proposals*. The committee underlined the point at: NEC Box LXVIII. HPC: 13th February 1978.
[193] NEC Box LXVIII. HPC RE:1499/Feb 1978, *Economic Report and Budget Proposals*, p. 42, Table of Costings.
[194] NEC Box LXVI. Liaison Cttee: 24th October 1977.
[195] Benn (1989), p. 413, 3rd July 1976.

Labour Party prioritised spending, so the diverse figures covered by this description – which included senior unionists (notably Jack Jones), Castle and Crosland – had different backgrounds in the party and different friends. This led to mutual mistrust. Crosland mistrusted the unions' social-democratic rhetoric believing "they did not deal with the question of priorities".[196] Castle thought that Crosland would "always toe the Treasury line…for all the oratorical gestures he likes to make."[197]

Social democrats retained clear loyalty to the long-run goal of higher spending. Crosland for example, unlike the Right, remained clear that the eventual aim should be a return to steady public spending growth, which would probably have seen it grow further in GDP.[198] The TUC argued at the depth of the IMF crisis that "essential features of the movement's programme" such as higher pensions should not be compromised because of a short-run crisis.[199]

This long-run aim produced shared alarm at the apparent philosophical shift which the Labour Right had undergone. Castle ordered researchers to:

> "draft an attack on [the] new Right-wing philosophy which…[was] spreading, not only in the *Financial Time*s but among Right-wing members of the Cabinet [which saw cuts as] positively socially desirable."[200]

Crosland complained the Right had surrendered ideology to "pragmatism, empiricism, safety first". They risked accepting "horrible", "illiterate & reactionary attitude to public expenditure".[201] Hattersley reacted so strongly to Jenkins' claim that "60 percent of national income devoted to public spending would lead to tyranny" that he severed a longstanding alliance with him.[202] TUC leaders felt similar unease. In rejecting the "dogmatic" anti-social-democratic arguments of the February 1976 White Paper they warned that

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196 Interview: Lord Lipsey.
197 Quoted in Dell (1991), p. 187.
198 Interview: Lord Lipsey.
199 NEC Box LXIV. Liaison Cttee: 6th December 1976.
200 Castle (1990), p. 678, 24th November 1975.
201 Crosland (1982), p. 354-56.
202 *Ibid*, p. 315.

Labour must not move towards a "Tory conception" of tax-and-spend which emphasised only narrow "self-interest".[203]

Underlying the social democrats' continued statism was continued egalitarianism. Castle opposed tax cuts because her "whole social policy was based on the fact that relief through the tax system did not reach the poorest who most needed help."[204] In December 1976 Crosland's egalitarianism saw him join with the Left to oppose benefit cuts.[205] He continued to press for the state to do more redistribution, in spite of hard times: a 1976 speech argued that "fairer tax" was amongst priorities so urgent that they must "be pursued with even more determination when the going is hard."[206]

This shared reaction meant that in spite of mutual mistrust, social democrats fought cuts together. In the autumn 1975 cuts debates, Gaitskell's lieutenant, Crosland, found the Bevanite Castle "his strongest ally".[207] They argued together that "it was wrong to assume that people would automatically prefer cuts in public expenditure to higher taxes."[208]

But there were differences. Crosland accepted some short-term cuts as the largesse of the mid-1970s offended his gradualism. His advisor judges that:

> "the truth is that in [1974 and 1975] we did not have public spending growing at a Croslandite rate…we had public spending running out of control." [209]

This view lay behind his famous warning to local government that current spending growth was too fast – "the party's over", albeit, he hoped, only "for the time being".[210] This gradualism ultimately made even the IMF cuts acceptable: they were not "a refutation of Croslandism" if seen as a short-

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[203] NEC Box LXII. Liaison Cttee: February 26th 1975.
[204] Castle (1990), p. 526, 25th November 1974.
[205] Benn (1989), p. 684, 6th December 1976.
[206] Crosland (1982), p. 357.
[207] *Ibid*, p. 307.
[208] Castle approving description of Crosland's view in Castle (1990), p. 633-34, 14th July 1975.
[209] Interview: Lord Lipsey.
[210] Speech at Manchester, 9th May 1975. Quoted in Butler and Butler (1994), p. 274.

run measure.[211] His chief concern in fighting cuts was thus to preserve demand (and so jobs), not to protect social spending: Keynesianism was integral to his approach, and he rejected inflation-control through unemployment as unjust.[212]

Castle, in contrast, consistently supported higher tax-and-spend even in the short-run, as she sought rapid, rather than gradual, change. Plans merely to *delay* child benefit produced such fury that official minutes record her as "very angry".[213] Furthermore, unlike Crosland, her chief interest was increasing tax-and-spend, not demand. She fought all tax cuts arguing that: "Everyone knew that tax reliefs meant a loss of revenue for public expenditure."[214] This opposition extended even, for example, to tax cuts targeted at pensioners.[215]

Castle's attitude was shared by the TUC leadership. After 1975's tax rises "the General Council recognise[d]" that the increase in the social wage that it approvingly calculated had *necessarily* "involve[d] increases in tax". Yet it urged still further spending on "housing and pensions".[216] The Chancellor's argument that tax was too high was met with the reply that "other countries also had high, if not higher levels of taxation".[217] Even in 1976, they demanded the pensions earnings ratchet be replaced with an even more generous scheme and expressed enthusiasm for certain tax-raising measures.[218]

But both Castle and the union leaders had declining influence. By 1976, as section 3.2 showed, the TUC was judged apart from its members by ministers, reducing its influence. Castle, meanwhile, was sacked in April 1976. By the time of the final 1976 cuts debate, the only determined social democrats in cabinet were Crosland and his protégé, Hattersley, and their opposition to short-run spending cuts was macroeconomic. Their alternative to the IMF cuts ultimately had two components. First, import deposits. Although effectively a tax (on imports), they were:

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211 Interview: Lord Lipsey.
212 Crosland (1982), p. 356.
213 NEC Box LXIII. Liaison Cttee: July 21st 1976.
214 Castle (1990), p. 526, 25th November 1974.
215 *Ibid*, p. 518, 14th November 1974.
216 NEC Box LX. *The Development of the Social Contract.*
217 NEC Box LXII. Liaison Cttee: 26th February 1975.

> "preferred not primarily as a tax increase, but as a way of reducing imports… The revenue yield to that which enabled you to keep up public spending was a second-order advantage."[219]

Secondly, smaller deflation. Their proposal was for a "presentational job" to the IMF involving creative accounting (including re-announcement of old cuts) underpinned by a threat to impose a 'siege economy' which it was hoped would be sufficient to persuade the IMF to accept a smaller real PSBR reduction.[220]

Once this was rejected, and a substantial deflation settled on, social democrats did not argue with other ministers over the 'deflationary balance' between tax rises and spending cuts. Indeed, Crosland "hoped there would be tax remissions" to compensate for the cuts. Although he suggested that favourable conditions would "maybe even" allow some reversal of cuts, this resistance was token, as he also urged the forward announcement of tax cuts which meant effectively committing to redistribute the fruits of growth to the private-sector.[221] So, ultimately, the social democrats did not resist the short-run decision to cut tax-and-spend.

5.5 The Outcome

Eventually, a Cabinet originally committed to expanding the state approved three major rounds of cuts without resignations. This chapter suggests this reflected more than respect of constraints. The Right had shifted ideologically. It had abandoned egalitarianism, which had been the chief rationale for statism. Further, it ceased to assume publicly provided goods were a more pressing need than private consumption. Although half the Cabinet did not move ideologically with the Right, and did resist cuts, their defence of spending proved ineffective.

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[218] NEC Box LXIII. Liaison Cttee: 26th April 1976.
[219] Interview: Lord Lipsey.
[220] Benn (1989), p. 667, 1st December 1976.
[221] *Ibid*, p. 674 & p. 678, 2nd December 1976.

The Left's programme could never have won majority cabinet backing. Proposals for severe import restrictions were politically unacceptable as they breached EEC membership, which the public had recently resoundingly endorsed. More generally, the AES ruled out potential allies on spending. Crosland, for example, could never have embraced a strategy that he felt "essentially aimed at recreating" the "war-time planning apparatus", when "the whole purpose of the *Future of Socialism* had been to demolish all that kind of thinking."[222]

Social democrats suffered specific weaknesses in an increasingly bipolar debate. Britain's recurrent mid-1970s crises combined with post-war disappointments to suggest a more drastic prescription was needed than Crosland's, for "defensive battle to preserve post-war achievements against the rising threat of New Conservatism."[223] Labour's centre was thus weakened, as the 1976 leadership election showed. Crosland's bid to seek "common ground which unites both" Left and Right brought just 17 votes, whereas each of the other five candidates – all clearly identified with Left or Right – received at least 30.[224] In Cabinet, this same weakness left Hattersley as Crosland's only loyal backer.

More fundamentally, both groups' opposition to cuts reflected a macroeconomic stance that seemed incredible. Both proposed that cuts be avoided with borrowing rather than tax, a position that signalled indifference to inflation, whose rates were high throughout 1975, and again rising during the IMF crisis. When, for example, Benn told Cabinet that "the [alternative] strategy involves a higher rate of inflation", its rejection seems unsurprising given that its rate was already approaching 30%.[225] Yet once reflation was rejected, no one pushed hard for deflationary tax rises as a second best, as these also threatened the unemployment whose avoidance both groups felt to be the top priority. Besides, social-democratic gradualism implied short-run restraint

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[222] Interview: Lord Lipsey.
[223] Crosland (1982), p. 356.
[224] Quote from Crosland (1982), p. 315. Voting figures from Butler and Butler (1994), p. 136.
[225] Note for Cabinet: "The Alternative Economic Strategy in Outline", in Benn (1989), p. 726.

on tax after rapid rises in the mid-1970s, while many Left-wingers felt depressed private living standards were more pressing than public services. In the last, no one pushed increases in tax to preserve short-run spending, and this allowed those who had abandoned tax-and-spend for long-term to prevail.

6: Conclusions

Section 1.3 showed recent historiography has cast doubt on earlier claims that the 1974-79 period was a watershed in economic policy. This paper restores the period to that status, but for new reasons: it began the reversal of post-war trends in tax-and-spend. Labour was elected pledged to extend the state, and it did just that for 18 months. Yet from 1976, tax-rates declined while spending was cut. This break with post-war trends anticipated Thatcherism.

Interpretation of Labour's reversal depends on *why* spending cuts were chosen over further tax rises. Short-term pressures were certainly important: inflation weighed heavily in 1975, as did 'confidence' in 1976. And towards the end of Labour's term, the public mood certainly became anti-social-democratic, which encouraged the Government to further the retreat it was already embarked on. But the structural constraints that have been hypothesised – resource crowding-out and excessive marginal rates – have been shown to have had little objective bearing and little influence on government. Nor do polls suggest a decisive, prolonged anti-social-democratic sea change in public opinion. So the *long-run* limits of social democracy did not enforce prolonged reversal of post-war trends. Once political and macroeconomic difficulties had passed, social democracy *could* have been resumed.

Still, that it was not depended on more than the election of Mrs Thatcher. Labour itself had undergone ideological changes. For a large part of the party the abandonment of social democracy was voluntary. Those still supporting higher spending did so ineffectually. Social democrats were weak in an increasingly bipolar debate, while the Left's wholesale radical package was never likely to be implemented. But most decisively, ministers opposed to cuts advanced reflation – not higher tax – as the alternative. Once this was rejected, neither group was willing to push hard for tax rises. Even the party's Centre-Left, then, temporarily lost enthusiasm for tax-and-spend. First, because it too felt that private consumption was already unacceptably depressed. Secondly, because employment was its chief concern, and tax rises threatened this as

surely as spending cuts. The cessation of the growth of tax-and-spend, then, largely reflected Labour's lack of will to defend it.

This conclusion raises obvious questions for future research. Did breaks with social-democratic trends in *other* countries reflect similar ideational changes? And, how did waning British support for tax-and-spend relate to the performance of 1970s public services?

Our understanding of how the mid-1970s proved a watershed in fiscal policy might finally be taken as suggestive for the interpretation of contemporary events. The recent Comprehensive Spending Reviews saw a British government plan a prolonged increase in the public sector's share in GDP for the first time since the mid-1970s. Could this represent the first signs of a new break in the history British tax-and-spend? Might the social-democratic approach, alien to governments since the 1970s, be resurgent?

Appendix: Background information

I: Outline Chronology[226]

1974

28th February

General election: Labour wins three more seats than the Conservatives

4th March

Harold Wilson forms a minority government

26th March

Budget: income tax increased and made more progressive; public spending increased

22nd July

Reflationary mini-Budget cuts VAT 2%

10th October

General election: Labour wins overall majority of 3

1975

18th March

Deflationary budget: income tax increased sharply. Minor spending cuts.

5th June

Referendum endorses EEC membership

9th July

TUC approves tight pay-policy

11th November – 11th December

Over various Cabinets principle and detail of first major cuts agreed

1976

19th February

Government announces first major cuts in Expenditure White Paper

4th – 5th March

Run on pound begins; £1 < $2 for first time

5th April

Callaghan replaces Wilson as PM

6th April

Budget: pay-policy conditional income tax cuts; cash limits applied to 75% public spending

19th – 22nd July

Cabinet agrees and announces emergency fiscal tightening: £1 billion in National Insurance increases and £1 billion in spending cuts

29th September

[226] The chronology covers only events that are central to analysis in the main text. It is largely based on a fuller timeline provided by: Wickham-Jones, Mark, "A Calendar of Events", in Artis, Michael and Cobham, David (ed.), *Labour's Economic Policies, 1974-79* (Manchester: Manchester University Press, 1990), pp. 278-295.

Healey announces he is to apply for IMF credit

23rd November – 7th December

Series of Cabinets debate principle and detail of conditions attached to IMF application. Final decision is for significant spending cuts.

15th December

Letter of Intent to IMF signed

1977

29th March

Budget offers pay-policy conditional tax cuts including 2% reduction in the basic rate of income tax, of which 1% is eventually delivered.

1978

11th April

Reflationary Budget combines tax cuts with modest spending increases

1979

3rd May

Conservatives win general election

II: Principal Persons[227]

Includes all participants referred to in main text and interviewed. No dates are given where one post held 1974-79.

Tony Benn: Industry Secretary, 1974-75; Energy Secretary, 1975-79
James Callaghan: Foreign Secretary, 1974-76; PM, 1976-79
Barbara Castle: Secretary for DHSS, 1974-76
Tony Crosland: Environment Secretary, 1974-76; Foreign Secretary, 1976-77
Edmund Dell: Paymaster General, 1974-76; Trade Secretary 1976-78
Bernard Donoughue: Head of Number 10 Policy Unit.
Michael Foot: Employment Secretary, 1974-76; Leader of the House, 1976-79
Judith Hart: Minister for Overseas Development, 1974-75 and 1977-79
Roy Hattersley: Junior Foreign Office Minister, 1974-76; Prices Secretary, 1976-79.
Denis Healey: Chancellor
Roy Jenkins: Home Secretary 1974-76
Jack Jones: leader of the TGWU (until 1978)
Harold Lever: Chancellor of the Duchy of Lancaster
David Lipsey: Advisor to Tony Crosland, 1974-77; Advisor to Number 10, 1977-79
Roy Mason: Defence Secretary 1974-76; Northern Irish Secretary 1976-79
John Morris: Welsh Secretary

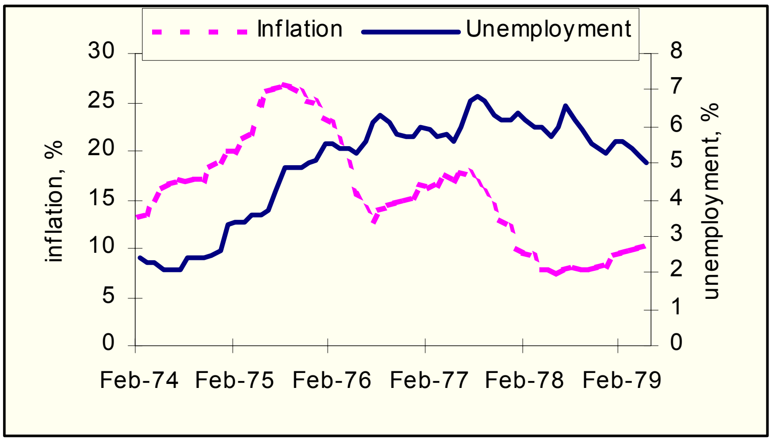
[227] The main source is Butler and Butler (1994).

Fred Mulley: Transport Minister 1974-75; Secretary for Education 1975-76; for Defence 1976-79
Stan Orme: Junior Minister Northern Ireland, 1974-76; DHSS Cabinet Minister, 1974-79
William Rodgers: Junior Defence Minister , 1974-76; Transport Secretary 1976-79
Peter Shore: Trade Secretary 1974-76; Environment Secretary 1976-79
Douglas Wass: Treasury Permanent Secretary
Shirley Williams: Prices Secretary 1974-76; Education Secretary 1976-79
Harold Wilson: PM 1974-76

III: The Macro-economy

Figure A.1 shows the two most vital key macroeconomic variables under Labour. Unemployment is measured as the fraction of the Labour force claiming benefit.

Figure A1: Unemployment and Inflation[228]



IV: Labour Party Committees[229]

Labour's conference is theoretically the Party's sovereign body, but as this could not practically run day-to-day affairs, the Movement elects the NEC to represent it, under Labour's 1918 Constitution. The NEC's composition reflected the party's federal structure, with members from each of the Constituency Labour Parties, trade unions, socialist societies, and the women's section. Reforms in 1931 and 1937 increased the weight and autonomy of Constituency Parties in determining NEC composition.

[228] Source: ONS website.

[229] These notes are based on Harmer, H., *The Longman Companion to the Labour Party 1900-1998* (Longman, 1998), to which the reader is referred for more information.

Detailed NEC economic discussion issues took place in the HPC and its various sub-committees. It is the minutes of these meetings that this paper looks to gauge Party opinion.

In 1972 the TUC-Labour Party Liaison Committee was established to co-ordinate the approach of unions and Party. It had equal membership from each of: the Parliamentary Party (typically senior ministers or shadow-ministers), the TUC and the Constituency section of the NEC. The minutes of this committee have also been extensively employed.

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Office for National Statistics, website: www.ons.gov.uk

b) Opinion Polls

Crewe, I., Fox, A. and Day, N., *The British Electorate, 1963- 92* (CUP: Cambridge, 1995)
Gallup Political Index (Social Surveys (Gallup Poll), various editions)

c) Labour Party Documents

Minutes and reports from the following committees have been used:

The TUC-Labour Party Liaison Committee
The National Executive Committee
The Home Policy Committee of the National Executive Committee
The Home Policy Subcommittee on Finance and Economic Affairs
The Home Policy Subcommittee on Social Policy

All evidence stored at the National Labour Archive at the National Museum of Labour History, Manchester. References to NLA materials give the NEC box number and the date of the meeting or the report. Documents before committees are labelled: "RE: [Number]/[Month, Year]".

See appendix for information on the committees.

d) Interviews

Lord David Lipsey, 15th August 2000
Lord William Rodgers, 3rd August 2000
Lord Peter Shore, 2nd August 2000
Sir Douglas Wass, 4th August 2000
Full transcripts available on request.
Lord Bernard Donoughue, 4th September 2000
Informal telephone interview, notes and quotes available on request.

e) Party Manifestos

Manifesto page references are as compiled in:
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