The Labour Party and Taxation

*Party Identity and Political Purpose in Twentieth-Century Britain*

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1 Struggles within a liberal inheritance, 1906–1940

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

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

Although Labour faced an uphill struggle, its own perspective and character changed considerably in these years. By the inter-war period Labour was no longer a trade union pressure group but a governing party, no longer proletarian but with a strong middle-class element. Ambitions developing in the 1920s had a different and more confident trajectory from those of the founding fathers. This chapter explores some of the contrasts and connections within this theme as it involves the party’s tax policy, and in so doing pays particular attention to two individuals, Philip Snowden and Hugh Dalton. For Snowden,
establishing the independence of the party and winning acceptance for it were the fundamental aims, and the project seemed to end in failure and rancour. While progress was made within the reassuring milieu of pre-1914 liberalism as it was driven by the confident radicalism of Lloyd George, by the 1930s there seemed to have been disengagement, as the pressure of government and budgetary crisis suggested a tension between radicalism and credibility which Snowden was both unable and apparently unwilling to resolve. Finance, from being an arena in which Labour could prove itself, had become one which tore it apart, and the demon of the ‘iron chancellor’, which was to constitute a problematic strand in Labour’s governing performance, was born. Snowden’s career therefore embraces both the promise and the limitations of the liberal inheritance in which he and the party had to operate, and the destructive tensions which this could unleash upon the party in time of crisis.

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

But what exactly was the difference between the two? Did Dalton’s expertise mark a significant advance upon Snowden’s perspective on tax in the 1920s? How far had the party gained ground when war broke out
in 1940, from its earlier positions? Here, as in the 1920s, the relationship with Liberals is instructive, and damaging.

**Labour and Liberals before 1914**

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

Whatever MacDonald might have said about Labour being an

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4 *LPAR*, 1906, p. 58.
independent party, it was operating within the context set by a radical liberalism in which taxation was a key element and where propertied opinion was more fearful of Lloyd George than of Snowden. There has been academic debate about the nature of British socialism and its links with liberalism. Those dealing with the electoral success of the party have pointed either to organizational or the class bases of its growth, rather than any distinctive programmatic appeal it might have had. By its nature, taxation was unlikely to clarify the division between liberals and socialists; for some it was a stopping point, for others simply a preface to more thoroughgoing change achieved by the state ownership of property. Snowden recognized this when he argued that:

Whether we were socialists, or for the time being were content with the more modest title of social reformers, we were all agreed, he [Snowden] thought, that the work to which parliament should direct its attention was that of bettering the social condition of the people, and the instrument of taxation was one of the two chief means by which that improvement could be brought to pass.

Certainly, there was nothing that Labour was proposing that could not be found in the ideas of progressive liberals, or that departed in any significant way from the existing framework of tax policy. Harcourt’s development of death duties in 1894 paved the way for the development of inheritance taxation, while key features of a progressive income tax – graduation, differentiation and the separate taxation of high incomes – all flowed from the pre-1914 Liberal governments. Moreover, the social divisions upon which Labour’s tax policy fed were hardly in advance of what any liberal might have offered. References to socially created wealth, to the ‘non-producing’ parasite, and the stress upon the minority of the rich who were being targeted were familiar features both of liberal thought and the Labour programme. There was a common radical heritage which stretched back well into the nineteenth century, now supplemented by the notions of socially-created wealth and surplus from J. A. Hobson. Certainly the statements of the new liberalism were, at their most practical, arguments about the necessity and acceptability

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7 LPAR, 1909, p. 104. Snowden did not specify what the other instrument, besides taxation, was.

of a heavier tax regime. In L. T. Hobhouse’s *Liberalism*, for example, the stress upon the limits of what could be understood to be individually created wealth, the possibility that a ceiling of £5,000 a year on incomes might be compatible with free enterprise, and the view that only a few would have their freedom jeopardized for the good of the many, were all ways of adjusting attitudes to a high-tax regime. The emphasis upon the community and the common good required at a practical level that the rich were prepared to hand over a part of their incomes to the rest, and that property owners of more modest means understand that such a process was not a threat to their interests.

The achievements of the Asquith government and its chancellor, Lloyd George, were formidable. E. R. Seligman, the eminent American tax economist, believed that their reforms put ‘the English system in advance of that found in any other country’, because they were ‘attempting to realize the more modern social ideals in taxation’. The historian of progressive taxation has also seen the pre-1914 period as crucial, when it was driven by a coalition of expert opinion and popular demands towards ‘the higher taxation of the rich in order to ameliorate the inequality of income distribution, and to procure optimum welfare’. By 1914 England had a graduated income tax through the super-tax on incomes over £5,000 (but paid on the amount over £3,000, once the £5,000 threshold had been reached), graduated death duties and an effort in place to solve, through land value taxation, the previously favoured position of landowners. What could Labour achieve in this context, when the Liberals were carrying out all that they would have wanted to do themselves?

A guide to Labour’s relations with the Liberals over tax is provided by the Select Committee on the Income Tax chaired by Sir Charles Dilke, which examined the possibility of graduating the tax by levels and kinds of income. By reporting favourably on the possibility of taxing higher incomes more heavily than others and treating earned income more tolerantly than unearned, it encouraged the development of the tax in a quite fundamental way. Snowden, who was one of the witnesses examined by the committee, confirmed its importance in his pamphlet

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12 Keir Hardie was a committee member, and his biographer has commented how ‘The Committee helped to broaden the appeal of the new Labour Party and to give Hardie himself a platform for expounding the financial implications of the radicalism for which he stood’: K. O. Morgan, *Keir Hardie, Radical and Socialist* (London, 1975), pp. 158–9.
The Socialist Budget, published in 1907: ‘The report of Sir Charles Dilke’s committee concedes everything the socialist could wish for as to the practicality of carrying out the socialist plan of taxation. The principle and the practicality admitted, the rest becomes a question of details and degree.’

One of the problems facing the committee was the considerable ignorance about the numbers of taxpayers enjoying certain levels of income, and therefore of the possible yield of the income tax if set at certain rates. According to the most expert and acknowledged non-partisan witness, the statistician Arthur L. Bowley, ‘whenever a scientific observer wishes to bring the test of statistics to the effect of a proposed reform in taxation, some essential information is found lacking’. The chairman’s draft report noted that in the 1890s ‘materials were wanting for calculating the number of people in the country with incomes exceeding £5,000 per year, or for arriving at the graduation of smaller incomes’, and ‘Even now, according to Sir Henry Primrose, these are perplexing and baffling questions.’ Although there was very broad agreement about the total income of those earning over £5,000 per year, the estimates varied from Primrose’s at £121 million to Sir Leo Chiozza Money’s at £250 million. The committee came down in favour of a figure around £200 million, believing that those which the Inland Revenue had supplied ‘failed to show the advance in large incomes which is notorious, and may be held to err on the side of understatement’.

The problem arose from the organization and administration of income tax. Pitt’s income tax of 1799 had required returns from individuals showing their total income from all sources, from which liability could then be estimated. Later, the tax was broken up into various schedules according to kinds of income (from property, salaries, profits, government stocks and so on), and where possible the tax was levied at a standard rate at source, without reference to the individual’s total income. Only if the taxpayer subsequently wanted to claim relief did he return his total income. If tax rates were uniform over a large part of the population, taxation at source was an efficient way of collecting tax. But it was insensitive to individual circumstances and

15 S. C. on Income Tax, xix, para. 26. £5,000 was the point at which reformers proposed a separate super-tax might begin; Sir Henry Primrose was head of the Board of Inland Revenue.
gave no information about individuals’ total income; only an obligatory tax return, with penalties for deception, would have fulfilled that function. But this raised wider issues about the individual and the state which went beyond matters of tax administration. The Inland Revenue thought the obligatory return for working out net personal income ‘must necessarily enter into details in regard to individual and family obligations of the most intensely personal and private nature’.

Conservative interests were certainly against the intrusiveness of a personal tax return. Felix Schuster, a banker, while admitting the valuable information which a tax return would bring, felt none the less ‘that such information could hardly be obtained unless the return was of such a complicated and inquisitorial character as to make it repugnant to the feelings of the community’.

On both fronts – information about the scope for the heavier taxation of higher incomes and on the administration of income tax – Leo Chiozza Money was an important and forceful witness. He had produced figures for total incomes at various levels as well as estimates for total wealth. Because Money was a radical Liberal MP, there was a tendency to place more weight upon the calculations of Bowley because, in Dilke’s words, ‘he came to us as a statistician animated by his love of science and disinclined to argue in favour of any particular view of income tax reform’. But such judgements should not hide the fact that Money was recognized as a serious and reliable investigator by tax experts. What Money laid before the committee was a scheme for a graduated tax on incomes and property for those earning over £1,000, which was dependent upon a personal tax return and rooted in the support of the majority of taxpayers below £1,000 a year. Against the fears that higher taxes would reduce savings and drive capital abroad, Money provided the argument that the state, through its spending of tax revenues, might contribute more to economic welfare than if the money remained in private hands for ‘luxurious and harmful expenditure’. Alongside other witnesses, especially T. A. Coghlan, the Australian government statistician for New South Wales, who was able to report practical experience of graduated taxation, Money presented powerful and reassuring evidence for tax innovation.

What sort of contribution did Snowden make to this committee? His expertise in tax, gained as a surveyor with the Inland Revenue, was not the same as Bowley’s or Money’s. He was not a statistician, but had

20 S. C. on Income Tax, draft report, p. 43.
21 Stamp, British Incomes, p. 404.
Labour and Liberals before 1914

been a minor functionary (like Sidney Webb) in the charge of the tax affairs of a locality, and had, as a result, been able to peer into the finances of many citizens, including those of the rich.\textsuperscript{22} His was the most likely kind of tax experience to emerge in the early days of a proletarian party, derived as it was from a lowly but significant bureaucratic office entered through modest educational qualifications.\textsuperscript{23} Snowden drew upon his experience to defend the practicality of his proposal for a super-tax on those earning over £5,000 a year. Discovery of such incomes would not be difficult because surveyors ‘knew approximately every person in their districts likely to have an income of over £5,000 a year’, and the administrative load would be manageable.\textsuperscript{24} Because Snowden was anxious to retain taxation at source as far as possible, and to focus on a very small group of taxpayers in order to minimize opposition, his proposal for a super-tax began at £5,000 per year. His scheme did look more modest than Money’s. Money began his graduated income tax at £1,000 a year, considerably lower than Snowden’s starting point, and the rates he proposed were stiffer than Snowden’s up to £25,000 a year.\textsuperscript{25} What caught the eye in Snowden’s proposal was the rate of 6 shillings in the pound on the top incomes over £50,000 a year. But the idea of a super-tax which Snowden was advancing was not new. It had been discussed at the time of Harcourt’s modification of the death duties in 1894 and in 1902 Charles P. Trevelyan had proposed an additional graduated super-tax on incomes over £5,000 a year, which required a personal income tax return as its method of assessment.

At first sight Snowden’s contribution might seem to have been both derivative and modest, but this would be too academic a judgement. The high rates he proposed on the very high incomes drew the fire of conservative interests on the committee, and more generally he won a place for Labour in the history of the graduated income tax even though the scheme was not entirely novel.\textsuperscript{26} This is what Labour required of him. There was no need to add to what the Liberals were doing since in

\textsuperscript{22} The ‘very considerable jealousy’ aroused by the surveyor’s knowledge of, and interference in, the financial affairs of local individuals was remarked upon during the sittings of the Royal Commission on the Income Tax after the war, Royal Commission on Income Tax, Minutes of Evidence, PP 1919, xxiii, part 1, q. 552, p. 25.

\textsuperscript{23} Later on both Douglas Houghton and James Callaghan were tax officials and drew upon this in their careers in the Labour Party.

\textsuperscript{24} S. C. on Income Tax, q. 1766.

\textsuperscript{25} Snowden’s figures come from his evidence at q. 1761, and Money’s from his paper presented to the committee and printed in the appendices, pp. 257–61.

\textsuperscript{26} Literally so, in that Snowden’s scheme appears in Richard Hopkins’s ‘Historical note on graduation’ as appendix seven of the first instalment of evidence to the R. C. on Income Tax, PP 1919, part one, pp. 51–3.
tax terms this met Labour's needs; what Labour wanted was an authentic and recognized voice within the stream of radical tax ideas, and this is what Snowden had achieved and reinforced on Dilke's committee.

The impact of war on the tax environment

In giving his evidence before the Dilke Committee Snowden had tried to be both cautious and prophetic in his proposal. When he stressed how limited the opposition might be to his idea for a super-tax he also indicated that he was ‘looking forward to a time when the tax will be much higher than anything I have suggested here’. In his autobiography, published in 1934, he wrote that ‘When I look back on my proposals in the light of later developments I am amazed at the modesty of my suggestions.’ ‘The application of higher rates was nothing to do with Labour; it arose partly from further tax increases by Liberal governments prior to 1914 but more significantly from the impact of the First World War.

It is important to establish how narrowly Labour interpreted the opportunities offered by war finance. These were seen to lie entirely within the area of personal taxation, even though the prospect of translating wartime experiments in company taxation into a peacetime instrument was actively considered, and was justified in terms entirely compatible with Labour’s ideological inheritance from new liberalism. The excess profits duty had provided the opening. True, it was a war tax like no other, and this was one of the powerful reasons advanced for its repeal after 1918. It had been part of the political bargain with the trade unions to ensure that business did not ‘make money’ out of the war. Two factors, however, made it a live issue in the discussions which took place about the nature of taxation after the war. First, it had generated a very high revenue – £200–300 million a year, a quarter of wartime revenue – and the pressing need for revenue after the war brought any successful tax into play; secondly, it had proved to be feasible, requiring only the addition of clerical assistance rather than more full-time staff. As one perceptive American observer noted in 1920:

The British Excess Profits Duty, if not the first of these special profits taxes, is certainly in many respects the greatest and best of them all. Its future place in the British financial structure constitutes one of the most acute problems confronting the British government today.29

27 S. C. on Income Tax, q. 2167.
The impact of war on the tax environment

The excess profits tax itself could not easily be retained in peacetime: through its use of pre-war profits levels as the standard by which ‘excess’ profits might be judged, it would have worked against firms employing new capital as compared with those older firms which had a higher pre-war standard and therefore a more favourable benchmark from which to assess subsequent earnings. But while it was not practicable to regard excess profits duty as a permanent peacetime tax, there was considerable interest in having some kind of tax on profits. The Board of Inland Revenue had a graduated profits tax under discussion in November 1918 and in the Commons in May 1919 Joseph S. Holmes, a Liberal, argued that ‘if taxation were so enacted that surplus profit would come to the state and to the common good, then I suggest that much of the prevailing discontent would disappear’. The notion of ‘surplus’ profit as a target for taxes was straight out of new liberalism, thanks to J. A. Hobson, and this was as much in the official mind as in the liberal outlook. Josiah Stamp, who had been largely responsible for the success of excess profits taxation during the war, pointed out how closely a business profits tax he outlined in the *Economic Journal* in 1919 came to finding Hobson’s ‘surplus’. Later, before the Colwyn Committee on the National Debt, Stamp pointed this out to him:

**Stamp:** Can you suggest any other scheme than that which I put forward of making your surplus a practical way of taxation?

**Hobson:** No, I do not think I can. I think that was a good way to approach it.

In the 1920s Hobson was a member of the Labour Party’s Advisory Committee on Trade and Finance, but neither he nor the Labour leadership seem to have taken any substantial interest in profits taxation. It had been anticipated within the Treasury that the opposite was going to be the case:

Labour has no doubt more ambitious schemes for dealing with the profits of industry, but it is difficult to imagine that the representatives of this class would not welcome the proposal, except perhaps a few extremists who will be satisfied with nothing short of state ownership. It may well be that Labour more than any other class will feel that the principle of the state taking a share of excess profits should not be allowed to fall into abeyance.


But the Labour Party and trade unions showed no interest in proceeding along these lines. It is true that the Labour MP Willie Graham, speaking in 1920 on the corporation tax introduced in that year’s budget, suggested that ‘it may be necessary in future for governments with a large social outlook to extend this tax’, but such pronouncements were rare.34 Snowden was primarily interested in death duties and income tax, and repealed the corporation tax in his 1924 budget, by which time there was, admittedly, little sign of any ‘surplus’ profits. Hugh Dalton, too, thought the tax set up inequities between the property holders, penalizing the ordinary shareholder whose earnings fluctuated with profits, and favouring those with fixed interest and safer investments.35

As far as personal taxation, Labour’s chosen ground, went, the war raised the level of extraction quite fundamentally, principally through increases in direct taxation. Total government receipts went up from 12.4 to 20.9 per cent of gross domestic product from 1913 to 1920; taxes on income increased from roughly 2 to 10 per cent of the same figure.36 While there was some containment of expenditure post-war, the tax demands of government never significantly retreated because of servicing the national debt and meeting social expenditure in the 1920s and financing rearmament in the later 1930s. While the structure of taxation had been put in place before the war its levels increased dramatically as a result of it. In 1913/14 the standard rate of income tax had been 5.8 per cent; this peaked at 30 per cent in 1920/1 and never fell below 20 per cent in the later 1920s. In 1913/14 income tax and super-tax combined produced £1634.7 million, but £163.398 million in 1939. Changes in the main rates of direct personal taxes were as shown in table 1.

The impact upon particular groups was also impressive. Some higher-wage members of the working class paid income tax during 1916–20, whereas before the war their inclusion had been thought to be administratively impracticable. The public discussion of the tax changes brought about by the war was guided by Herbert Samuel’s address to the Royal Statistical Society in 1919, ‘The Taxation of the Various Classes of the People’. According to his figures the working and lower

34 H. C. Deb., 128, cols. 477–8, 21 April 1920.
middle classes (that is, those earning up to £500 per year) had seen their tax burdens doubled as a result of the war; those on more solidly based incomes of £1,000 had suffered a threefold increase, while those in the £2,000–£5,000 range of upper middle-class incomes had ‘suffered the most heavily in proportion’, having faced an increase of between four and five times the pre-war level. In the face of these across-the-board increases, the question of whose interests were to be served in the 1920s was an important one. The increases in tax did not give a specific guide, since everyone had suffered, and even if the rich were now taxed the most heavily this was perfectly consistent with the progressive principle laid down before the war.

By 1920 it was clear that the working class was not going to be centrally involved in post-war issues which revolved around direct taxation, even though during the war the exemption level had come down from £160 to £130 a year to embrace the better-paid industrial workers. When Snowden had protested at this development of war finance, Lloyd George argued that money could not simply be raised from the rich. The inclusion of such wage earners had doubled the number of income tax payers and had provoked some considerable opposition, chiefly amongst the miners of South Wales. There was understandable interest in establishing after the war just how easily this new taxpayer had been absorbed into the system. It was argued that the working man was a wholly different kind of taxpayer compared to the ones traditionally dealt with by Inland Revenue officials: ‘they do not always appreciate the difference of this new type of taxpayer as compared with the farmer, professional man or trader who previously

Table 1. Increases in the rates of certain direct personal taxes, 1913/1914–1919/1920

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<td>Income tax</td>
<td>1s. 2d</td>
<td>6s.</td>
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<td>Super-tax</td>
<td>6d</td>
<td>4s. 6d</td>
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<td>Estate duty (top rate)</td>
<td>15%</td>
<td>40%</td>
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Sources: Reports of Commissioners of Inland Revenue, PP 1913, xxviii; 1919, xxiv; 1921, xiv.

received the bulk of their attention. The workers had to respond to a quarterly assessment from the tax authorities rather than having their tax deducted by their employer, as was to be the system when wages were taxed in the Second World War. While the Inland Revenue officials reported themselves happy with the way tax collection had worked, George Carter, who represented the Labour Party at the Royal Commission on Income Tax, had also co-written an article in *The Economic Journal* in 1918 which argued that 'the Government has not realised the extent of the unrest nor its nature'. The feature of the tax to which Carter devoted some attention was the variability between districts of the allowances granted for tools and clothing which were regarded as necessities of working-class life, allowances for dependants other than the taxpayer's own children and some exemption of small amounts of unearned income. It was to be expected that workers would have a strong sense of the traditional concept that basic living costs, and the expenses incurred in generating an income, should be free of tax. The theme of Carter's article in *The Economic Journal* was that many of the grievances arose from the distinctive conditions of working-class life. Thus of the claim that allowances should be paid for dependants who were not necessarily the taxpayer's own children, Carter wrote that: 'This expense is one of the outstanding features of the wage-earner's budget. His home has ties and affections deeper than those of any other class in the matter of support to relations.'

There was a sense, however, that workers were arguing about features of the tax in much the same way that other taxpayers did, over the dividing line between what the Revenue regarded as an allowable expense and what was not; in other words, in much of the opposition there was not a significant class dimension. Trade unions representing the workers affected did not take a leading part in opposition to the tax, the Amalgamated Society of Engineers, for example, regarding it as a non-industrial question. Indeed, trade union leaders were sometimes frustrated that there was a more lively sense of grievance over income tax, which was a lighter and fairer burden, than over the indirect taxes to which the Labour movement had long been opposed. But in South Wales the miners' federation took an active part in opposing the income tax.
The impact of war on the tax environment

tax, and there were many cases of tax forms not being returned. The introduction of the wife’s allowance in 1918 increasingly turned it into a tax on the working-class bachelor and the reductions in wages from 1920 largely removed workers from income tax. Thus one of the most vociferous movements against the income tax changes of the war was essentially off the agenda from 1920 onwards.

But this first experience of the working class with income tax in any significant numbers had indicated the problems of legitimating tax burdens through factors internal to the tax in question. Income tax was usually reckoned to be legitimate because it was fair, in terms both of horizontal and vertical equity. In terms of the former, the allowances given to the married man should have distinguished his interests from those of the bachelor, but according to one trade unionist ‘the married man and the single man, as far as we are concerned, always go together’.44

For vertical equity to be a factor in consent, the higher rates charged on larger incomes also had to be acknowledged, but according to the following exchange between Robert Shirkie of the TUC and Sir William Maclintock of the Royal Commission this may not have been so:

Maclintock: You are aware of the fact that more than 10s. in the £ is taken from large incomes now by the state in income tax alone?
Shirkie: No, I am not aware of that.
Maclintock: Well, you should be.45

If members of the Royal Commission found some of the working-class representatives obtuse the most alarming proposition came from the Board of Inland Revenue, which identified the lower middle classes as the key group deserving relief under the new tax regime. According to Richard Hopkins, ‘while continuous efforts have been made to graduate the tax fairly according to the subject’s ability to pay, yet there is probably a general feeling that the pressure is hardest upon taxpayers in the lower portions of the scale and that some fraction of their burden might be transferred to the wealthy taxpayers’.46 Hopkins had in mind the range between £500 and £2,000, that is the lower middle and middle classes. An increase in the super-tax, which came in above this level, ‘would mitigate the disproportion in the comparative severity of the tax between medium and large incomes’.47

Some members of the commission were astonished at this judgement.

46 Ibid., evidence, part 1, q. 3997, p. 192.
47 Ibid., evidence, part 1, q. 4007, p. 193.
According to one, ‘I just want to have it on record that in spite of the very heavy burdens which are proposed under the present resolutions, the department still feels justified in recommending additional taxation of this character upon their [the wealthy] incomes.’ It was suggested that Hopkins was giving evidence not as a Revenue official but as a member of the middle classes.

Snowden’s views were broadly similar to those of the Inland Revenue. The working class did not deserve further relief from tax beyond that which had already been provided by the allowances for wives and children. The working class, in Snowden’s view, had to recognize that it ought to make some contribution to the costs of the state. Some of the claims by workers and unions that the income tax exemption level had to be raised and indirect taxes removed were indefensible: ‘The working classes, like every other class of the community, must bear taxation upon any surplus of income where it exists.’ The claim of the South Wales miners to have the first £400 of income exempted ‘brings ridicule upon the Labour Movement’. It was acknowledged that the main tax question was the pressure of income tax on the middle class and this brought in another legacy of the First World War around which Labour was to organize its approach to taxation in the 1920s, namely the national debt and capital taxation.

Snowden’s views during the war had certainly moved towards capital taxation and the national debt, but only in a limited way; the vigorous promotion of the issue had come from the Liberals. Snowden’s approach was derived as much from his general views about tax and capitalism as from particular features of war finance. Whereas Treasury ministers were alive to the dangers of excessive purchasing power (and therefore of the need for heavier taxation of the people), Snowden’s line was that the workers’ standard of living should not be reduced by additional taxes. Instead, there should, argued Snowden, be draconian taxation of the rich, because they wasted their money on luxuries. He did propose a capital tax in 1915 with a top rate of 10 per cent (when the top rate of estate duty was double that) but it was presented rather perfunctorily. He also believed that the level of borrowing used to finance the war was presenting unnecessary benefit to the rentiers, but he had nothing to offer that was comparable to the Liberal MP Sydney Arnold’s scheme for a capital levy to pay off the debt so as to relieve...
income tax from meeting the interest payments. Snowden was guardedly in favour. He was keen to underline that he did not support a capital levy as a part of the normal tax system and ‘In ordinary times I should have opposed such a proposal.’ But times were far from ordinary, and so the scheme had merit. But this very point – how far could Labour draw upon a legacy of the war in its peacetime tax strategy – was to be one of great difficulty for the party.

The national debt, expert opinion and Labour’s tax strategy

The debt issue arose because of the funding of the war partly through borrowing; most attention was devoted to the internal debt because it seemed to require a judgement about class interest. The internal debt was assumed to be costly because it represented a transfer of resources within the population from the economically active producers to the more passive rentiers, since income tax levied on the former went to pay the interest on the debt in the 1920s owed to the latter. With a lessening of the debt charge, income tax could be reduced, with beneficial effects upon incentives. Moreover, debt interest took up a large proportion of the budget, and chancellors must have found it galling to see so much revenue pass through the accounts to so little apparent purpose. Debt interest never became large enough to exceed direct tax payments, although at £273 million in debt interest compared to £293 million in direct tax in 1925/6 it was a close thing. The discussion of the debt always assumed that the transfers involved were between individuals, when in fact a number of organizations (such as charities and trade unions) had holdings of the debt. Interest payments to individuals were estimated to be about £100 million per year. This meant that the debate was conducted, as it were, within the confines of the direct tax

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53 H. C. Deb., 105, cols. 896ff., 23 April 1918.
54 H. C. Deb., 106, col. 253, 14 May 1918.
55 Provided by Walter Layton, editor of The Economist, to the Colwyn Committee on Taxation and the National Debt, evidence, para. 9, p. 175. These were rough estimates. An investor might have bought holdings in more than one issue of the War Loan, and his total holdings might have been spread amongst the several registers kept by the various agencies which dealt in War Loan. The only way of knowing about individual holdings was to examine the passage of War Loan at death through estate duty records. Harry Campion published a table giving the share of ‘British government securities issued since 1914’ (which included War Loan) in estates of various sizes from £100 upwards, for 1936. This showed that estates at all values had such securities in a range 10–15 per cent share of total assets. Rich people’s holdings were therefore larger in amount than poorer people’s, but War Loan was not just confined to the rich but spread within the middle classes: H. Campion, Public and Private Property (Oxford, 1939), table 11, p. 104.
population. Had the debt interest been so large as to exceed the proceeds of direct taxation and entrench upon the revenue from indirect taxation, to which the working class was heavily exposed, then it might have been presented as a question for the working classes too.

The one solution of the debt issue which engaged public discussion – a levy on capital, which would finance repayment of a significant slice (perhaps 50 per cent) of the debt in a once-and-for-all operation – generated an interesting question for middle-class taxpayers because it seemed to set against each other two core attitudes, one being attachment to property (violated by a levy) and the other a desire for low taxes (fulfilled by the levy). It might be argued that attachment to property was the core value from which a keenness for low taxes flowed, and this would always remain of prime importance. But the fact remained that the debt issue brought together a radical solution to meet the consequence of orthodox actions. The orthodox strategy for restoring ‘normalcy’ to the 1920s was a deflationary policy, after the socially disruptive inflationary conditions of 1918–20. As prices fell and the nominal value of the debt remained the same, ‘the taxpayer has the prospect of repaying two loaves for every one that he has borrowed’. Or as Keynes put it rather more sharply, ‘I think those people suffer from a certain confusion of mind who simultaneously hold we must indubitably restore sterling to par, in all circumstances we must respect contract, and in no circumstances must we have a capital levy.’

As well as the levy being a challenge to conventional thought it was also possible to make an appeal to the generally cautious middle classes, as Sidney Webb did:

There is an extraordinary delusion among the middle class – a delusion fostered by the wealthy as one of their means of defence against being made to contribute equally to the taxes – that the project of a tax on capital is put forward in the interest of the wage earners, in order to spare the mass of the people from paying any taxes at all. But, as a matter of fact, it is not as a substitute for the taxation of wage earners that the Capital Tax is proposed. It is proposed as a substitute for a crushingly heavy Income Tax on the whole body of professional and businessmen. The alternative for the doctor, teacher or minister of religion to consider; for the farmer or shopkeeper or manufacturer or merchant to ponder over; for the man or woman living on an annuity or on the proceeds of scanty savings to reflect upon, whether it is better to go on for all time paying an Income Tax at a nominal rate of 15s in the £ without a Capital Tax; or to have a

57 Josiah Stamp in *The Times*, 4 November 1922.
properly graduated Capital Tax once-and-for-all, in order to get income tax down to something like its pre-war rate.59

Labour’s project for the 1920s, therefore, was to segment the propertied interest into the rich and the middle classes, rather in the way that the Liberals had done before 1914. But the context was now different. While the ‘bondholder’ might possibly have filled the shoes of the urban landlord, the middle classes were, in the early 1920s, shaken by the experience of the First World War and its aftermath, which had seen an inflationary alliance between mobilized labour and the emerging state.60

In the light of his pamphlet on national finance and the levy cited above, and his involvement during the war in the ‘conscription of riches’ proposal as part of the War Emergency National Workers’ Committee’s opposition to conscription, Webb seemed to be poised to make a substantial contribution to tax policy in the 1920s. However, he declined to be examined before the select committee on the taxation of increases in wealth during the war which reported in 1920 because he declared that the scope of the enquiry was too narrow, and his evidence before the Royal Commission on Income Tax in 1919 was supercilious rather than considered. He seemed to be more preoccupied with the work of the coal commission, which was going on at the same time and which, since it dealt with the issue of national ownership, might have seemed more weighty compared to taxation. Webb’s absence from tax discussions in the 1920s broke the connection between taxation and social policy which was not renewed until Richard Titmuss’s work on income tax in the 1950s. In the intervening years the economists monopolized discussions about tax.

Labour had a number of MPs interested in tax questions in the 1920s. Hugh Dalton and Frederick Pethick-Lawrence both came from the same intellectual background, created by Alfred Marshall and Arthur Pigou, which was sceptical about the necessity for large aggregations of wealth but anxious to protect the activity of saving.61 Although Pethick-

59 Sidney Webb, National Finance and a Levy on Capital (London, 1919), p. 15. The standard rate of income tax at this time was 6s in the pound; super-tax was at 15s in the pound.
60 For a perceptive analysis of the middle-class experience at this time, see Ross McKibbin, Cultures and Classes, England 1918–1951 (Oxford, 1998), chaps. 2 and 3.
61 For books or pamphlets specifically on the levy, Dalton wrote The Capital Levy Explained (Edinburgh, 1923), Will Capital Leave the Country? (1924), and Pethick-Lawrence, A Levy on Capital (1918), The Capital Levy (1920) and The National Debt (1924). Both gave evidence before the Colwyn Committee on the National Debt at proceedings in 1925. Because one of the originators of the levy idea, Sydney Arnold, was not appearing, Dalton wrote to Pethick-Lawrence that ‘it is all the more important that you and I should both weigh in’: Trinity College, Cambridge, Pethick-Lawrence papers, letter from Dalton, 26 January 1925, box 1, f. 178.
Lawrence had set out in the early years of the war what was to become the essential case for the levy – that internal borrowing ‘allows richer classes to secure a lien on future prospects of the country out of all proportion to the sacrifices they have made during the war’ – it was another Liberal MP, Sydney Arnold, who first elaborated a scheme in the Commons.62 Another ex-Liberal, H. B. Lees-Smith, also wrote on tax questions and was to be prominent in the surtax discussions of the later 1920s. He served as a member of the Colwyn Committee. Josiah Wedgwood, who had joined the Independent Labour Party in 1919, came from the Henry George single tax background but made something of a speciality of inheritance taxation, publishing in 1929 The Economics of Inheritance. Henry George’s idea of a single tax on land had some influence upon the early Labour Party, although a contrasting preference for land nationalization and the insistence that capitalism as well as landlordism had to be controlled marked off some Labour thinkers from the ‘land value’ liberals. But the sense that there was a mass of assets called ‘capital’ which was detached from production and was not the outcome of current enterprise and therefore could be attacked through the tax weapon with relative impunity, and a corresponding lack of interest in taxing corporate earnings, was a common feature of both. Willie Graham, the MP for Edinburgh and Snowden’s deputy at the Treasury in 1924, made his mark through taxation less because it was a dimension of a broader ideology but rather a subject to be mastered in detail by an assiduous but self-effacing individual who could therefore earn approval and regard.

Dalton was different from the other Labour MPs who had an interest in finance in coming from a Conservative rather than a Liberal background.63 He came from that particularly detached form of Conservative family, one based in the Church, since his father had been a canon of St George’s Chapel, Windsor. He joined the Fabian Society while at Cambridge and then went to the London School of Economics where, under the supervision of Edwin Cannan, he prepared a dissertation on the inequality of incomes, subsequently published in 1920 as Some Aspects of the Inequality of Incomes in Modern Communities. In the same


63 The converts to Labour from Conservatism – interpreted to mean family as well as personal background – have recently been explored by Martin Pugh, “Class Traitors”: Conservative Recruits to Labour, 1900–1930, English Historical Review, 113 (1998), pp. 38–64.
year he published a more technical article in the *Economic Journal* on ‘The Measurement of the Inequality of Incomes’, which much later contributions from Amartya Sen and Tony Atkinson have developed. Dalton’s monograph not only discussed the study of inequality in the economics literature but also set out what were to be his enduring views on the subject. He stressed his critical attitude towards Marx – ‘If no better arguments for socialism could be found than those contained in his pages, it would indeed be a lost cause’ – and the inadequately recognized significance of inheritance for perpetuating and augmenting the transmission of inequality across generations.\(^6^4\) There were also suggestions for specific measures to deal with these questions, in particular support for the Italian economist Eugenio Rignano’s scheme for differentiating between lifetime accumulation and inheritance from an earlier generation in the taxation of an individual’s estate, as well as the capital levy which would reduce the public debt by wiping out a large number of property rights and their income.\(^6^5\) Dalton’s intellectual interests, coupled with his ‘conversion’ from a conservative background, indicate that, like others, his inspiration came from hating his own class rather than drawing upon the confidence which such a background might have given to engage in reform from above. As his biographer has commented, ‘Tories felt, and they may have been right, that for all the intellectual sophistication of Dalton’s utilitarianism, emotionally he was less interested in helping the poor than in hurting the rich.’\(^6^6\) This distinction was not only of interest for an assessment of Dalton individually; it certainly shaped a good part of Labour’s outlook in the 1920s and 1940s when hostility to the *rentier* informed the levy and surtax policies as well as ‘cheap money’ under the Attlee government of 1945–50.\(^6^7\) It may also have contributed to a view of taxation as an end in itself in its connection with equality – that is, for what it might take away – rather than for its contribution towards the financing of social reforms which served equality through improving the lives of the poor. Had social reformers continued to have an interest in taxation in the 1920s it is unlikely that the Labour Party would have had such an approach to inequality as Dalton; it might have deployed a more instrumental, and more productive, view of tax as a result.

Whatever the ultimate consequences for the Labour Party of Dalton’s

\(^{64}\) Dalton, *Some Aspects of the Inequality of Incomes in Modern Communities* (London, 1920), pp. 83 and 271.

