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THE INFLUENCE OF PARTY COMPETITION ON POST-WAR UK TAX RATES

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This paper is concerned with the influence of the British system of 'party government' on tax policy outputs. It has been argued that parties make little difference (Rose, 1984) and have only a minimal influence on the trends in tax revenues (Karran, 1985). This paper examines the post-war trends in the rates of income tax, corporation tax and consumption taxes in the UK. It is argued that there is a relationship between the trend in tax rates and the party in office. Hence, we conclude that parties do make a difference to the distribution of the tax burden, that this difference has recently been more pronounced, that it can be important to taxpayer/voters and that partisan influences have been detrimental to the development of the UK tax system.

> 'The rise of political parties is indubitably one of the principal distinguishing marks of modern government. The parties, in fact, have played a major role as makers of governments, more especially they have been the makers of democratic government. It should be stated flatly at the outset that this volume is devoted to the thesis that the political parties created democracy and that modern democracy is unthinkable save in terms of the parties. As a matter of fact, the condition of the parties is the best possible evidence of the nature of any regime. The most important distinction in modern political philosophy, the distinction between democracy and dictatorship, can be made best in terms of party politics. The parties are not therefore merely appendages of modern government; they are in the centre of it and play a determinative and creative role in it' (Schattschneider, 1942).

With this statement Schattschneider (1942) opened his classic study of American politics and encapsulated the conventional assumption that party competition is essential to the very functioning of representative democracy. To Schattschneider, and many distinguished political scientists (eg APSA, 1950; Polsby, 1983), democracy itself is founded in the party system. Such political scientists have assumed, not only that parties make a difference but also, that parties *must* make a difference.

In his iconoclastic analysis, *Do parties make a difference?* Rose (1984) confronts these assumptions about the role and effectiveness of modern political parties. Rose bluntly concludes that for the United Kingdom, between 1957 and 1983, partisan influence on public expenditure patterns is marginal compared to secular economic trends, especially inflation and economic growth. Public expenditure and taxation grow whichever party is in office. Public opinion is broadly consensual on major political issues and differences in party intentions (as measured by their manifestos) are less than is usually expected.

Rose's work has generated a great deal of controversy within the profession (von Beyme, 1984), but the empirical evidence which has been offered to substantiate the arguments on both sides has been inconclusive (Newton and Sharpe, 1984). While Rose has found no partisan differences in public expenditure patterns, Hibbs (1977), for the US, and Alt (1986), for 14 Western democracies, present evidence suggesting that parties do make a difference in determining the level of unemployment.

Rose's thesis is particularly interesting because he tests his hypothesis in a single country in which there are clear party alternations of government. Britain has been held up as the prime example of majoritarian two party competition (eg Epstein, 1980). British politics is uninhibited by the problems of minority government and/or of a fragmented political structure. It is reasonable to expect that parties have made a greater difference in the UK than in most other polities.

Karran (1985) examined the post-war British tax system and measured the effects of secular and partisan variables on revenue trends for every major category of taxation. He concluded that Rose's thesis '. . .that the impact of parties on trends in the economy is minimal compared with secular forces, is also applicable to taxation policy' (Karran, 1985, p. 385).

However, Karran does not argue that parties are irrelevant to tax policy outputs, and presents evidence showing that, for five out of the seven taxes for which significant results were obtained, there is a statistically significant correlation between 'party government' and tax revenue yield. As we shall see, it is significant that all of these were consumption taxes and, with the notable exception of Value Added Tax, higher tax rates occurred under Labour governments. Rather than suggest that parties make no difference at all, Karran's data correctly remind us that secular economic variables can have a greater impact on revenue yield than changes in party tax policy. It is the distribution of these yields, within tax categories, on which we concentrate.

Both Rose and Karran emphasize the constraints which limit any government's ability to absolutely define public and economic policy. Governments have little control over the course of secular economic trends; this does not mean they are helpless. *Confirming that there are things bigger than parties does not test for the relevance or irrelevance of political parties in modern democracies.*

Our study examines partisan influences on taxation so as to test Rose's question, 'Do parties make a difference?', through a micro examination of three different revenue categories; personal income taxes (PIT), consumption taxes and corporation taxes in the United Kingdom since the Second World War.[1] This analysis looks at the *rate structure* of taxes, which governments have direct control over, rather than revenue trends, which governments have only indirect control over. Rose's question is reformulated here and we ask 'what difference do parties make, and to whom?'.

Tax policy is a suitable area in which to identify partisan influences, both because effective changes can be made relatively easily and regularly and, because changes in tax laws can direct financial benefit to specific groups in society. Although parties may display a reluctance to initiate major reforms to the tax system, they do make frequent changes when in office with, as we intend to demonstrate, predictable effects on the distribution of the tax burden.

The other major field of direct government economic activity, public expenditure, is less amenable to the identification of partisan influences. Expenditure programmes have considerable momentum of their own and are very sensitive to shifts in macro-economic variables. This helps to explain why Rose (1984) was able to conclude that parties made little difference. The *constraints* under which governments must act are more prevalent and significant for public expenditure than for the structure of the tax system. Consequently, partisan influences should be greater for the tax system.

Tax policy also provides a particularly potent test for Rose's hypothesis because of the centrality of this issue to the Labour Party's redistributive aims on the one hand, and the Conservative Party's market stimulative ambitions on the other. Furthermore, adjustments are made to the tax system annually. These changes directly affect disposable income, one of the public's major concerns. If parties make no difference to tax policy, it may be reasonable to argue that they make no difference at all.

Parties and tax-policy outputs

The two major political parties in Britain have articulated widely divergent positions on taxation. On the basis of their respective manifestos over the past 40 years, these positions can be summarised as Tories promising to lower the direct tax burden and Labour promising to ensure that the rich will pay their 'fair share'. Dennis Healey (Labour's shadow chancellor) certainly captured a widely held Labour position when he announced on the election stump in 1972, "We will squeeze the rich until their pips squeak".

The Conservatives' position is based on the belief that lowering the direct tax burden will 'reward and therefore encourage effort [and provide] the best guarantee of individual choice and freedom' (*Conservative Party Manifesto*, October 1974). Labour argues that justice requires that 'tax burdens are progressively eased from those least able to bear them and that there is a greater contribution to the National Revenue from the rich' (*Labour Party Manifesto*, 1970). Were the parties to do as they promise, the tax burden on the rich should go up when Labour is in power and should go down when Tories rule. This is the hypothesis to be investigated in the following discussion of the post-war experience for income tax, consumption taxes and corporate profits taxes.

Personal income tax.

The personal income tax (PIT) is the most visible of taxes. A voter, following the analysis of

Wilensky (1982), cares about the PIT because it has a direct effect on take home pay. Therefore, governing parties could be expected to alter the PIT rates to influence voters. It does not appear that they have done so; the revenue yield from PIT has varied since 1948, but the correlation to party in power is weak (Karran, 1985; Rose and Karran, 1983). However, politically relevant partisan changes are more likely to be found in the distribution of burdens *within PIT* than in the share of income tax in total tax revenue, since the latter is more sensitive to macro-economic variables.

The most suitable way to analyse changes in the distribution of the income tax burden over time is to consider changes in the formal tax rate (FTR). We define the FTR as total income, less universal allowances, multiplied by the nominal tax rate, and estimate it using published data in the *Inland Revenue Annual Reports.*[2] A general measure of the tax rate should capture changes in the phenomena being observed; while not perfect, the FTR reflects changes in the variables governments can use to manipulate tax rates.

There are two ways in which a government can directly alter the PIT structure so as to vary the FTR. First, changes in the nominal tax rate alter the percentage of taxable income absorbed by income tax. Since the PIT is progressive, taxable income is divided into bands such that higher bands incur higher marginal tax rates, ie the average tax rate rises with income. The average tax rate is the important concept in our analysis and can be increased either by increasing marginal tax rates or by narrowing the tax bands. Secondly, changes in allowances alter the proportion of income which is taxable. An increase in allowances, either in the money value of particular allowances or in the range of allowances available, reduces the average tax rate because a lower proportion of income is taxed. This will imply a reduction in FTR unless there is an off-setting increase in nominal tax rates.

Inflation complicates the analysis by affecting the real values of allowances and tax bands. If the PIT is not indexed (which was the case in the UK prior to the Rooker–Wise Amendment of 1977, now replaced by the 1981 Finance Act), and incomes rise in line with inflation, then fiscal drag implies an increasing formal tax rate: a greater proportion of real income is liable to tax if allowances and tax bands fail to keep pace with inflation. Even if the PIT is indexed, another form of fiscal drag arises if incomes rise faster than prices; again, a higher proportion of income is taxable and the average tax rate rises.

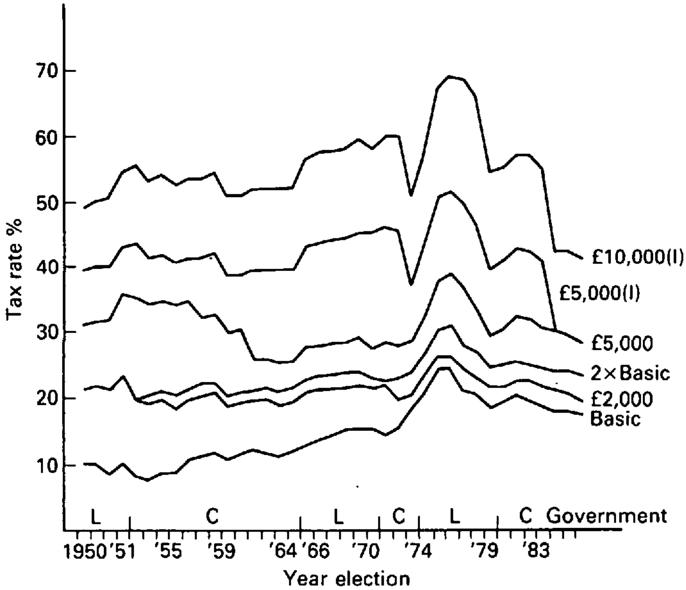
In order to compare the trend in FTRs over time, and distinguish the influences outlined above, we calculate FTRs on constant real incomes and constant relative incomes (Graph 1). Constant real incomes are incomes with equivalent purchasing power in each year. They are in 1970 prices; the value for other years was obtained by deflating (or inflating) by the Retail Price Index (*RPI: Economic Trends,* 1986). Constant relative incomes are those in the same ratio to the average wage in each year. Taking the basic weekly wage for a manual worker in 1972 as £1,630 (*Social Trends,* 1976, p. 116), we deflated/inflated this by the index of basic weekly wages for manual workers (*Economic Trends,* 1986; Average Earnings had to be used after 1983).

It must be strongly emphasised that our concern is with party influences on relative tax rates rather than on absolute tax levels. Partisan influences can determine the *direction of change in relative tax rates* but the level of tax rates is likely to be determined by the constraints faced by governments, in particular, macro-economic factors. For example, rapidly increasing incomes will cause FTRs, and PIT revenue, to increase; any effect on relative tax rates will be progressive. Hence, a fall in tax rates or a regressive change in relative rates will indicate direct government policy. The party in power can allocate the costs, or benefits, of macro-economic trends.

The calculated FTRs are for a married couple where the husband is the sole earner, and a distinction is made between earned and investment incomes, the latter being designated by (I) in Graph 1 and Table 1. Investment incomes were more heavily taxed than earned incomes until 1984, when the Tories abolished the investment income surcharge (Graph 1). It can be noted that a constant income of £2,000 (1970 prices) was, in the period 1948–52, equivalent to an income of twice the basic wage (2 × Basic — see Table 1). By 1967, the equivalent real income was £2,500 while by 1986 it was about £3,300, demonstrating that earnings rose faster than prices so that the FTR on 2 × Basic rose faster than that on £2,000 (Table 1).

Before discussing the data, it will be useful to indicate the proportion of income taxpayers represented by each sample income. In 1979, some 56% of taxpayers had incomes not greater than the basic wage, and about 68% had incomes below £2,000 (1970 prices). On the other hand, only 0.8% of

GRAPH 1 Post-war trend in formal tax rate on sample fixed incomes, married couple, 1948–86.



NOTES: Percentages rounded to nearest 0.5%

SOURCE: See Table 1.

taxpayers had incomes above 4 x Basic, while those with incomes above 6 x Basic, or £10,000, numbered 58 — some 0.25% of all income taxpayers (Inland Revenue — *Survey of Personal Incomes*, 1980). Nevertheless, tax rates on these high earners are an important source of political controversy, indicating the symbolic nature of tax policy, and of party differences. For individuals paying very high marginal tax rates, a small change in the tax rate means a proportionally greater change in disposable income.

The most general indication from the data is that, in the post-war period, income tax rates tended to rise regardless of which party was in power, and most of the rise could be explained by inflation and rising incomes, supporting the argument of Rose (1984). There is some support for the election budget hypothesis (Alt, 1980; Mosley, 1984) since FTRs display a tendency to fall in years where an election is intended, and to be at their highest between elections, which is consistent with Wilensky (1982). We examine the data more closely in Table 1, which gives the average tax rates, and the tax rates after the first and final budgets, of each party's period in office.

If we look at the FTR faced by the majority of taxpayers, 2 x Basic and below, there is no evidence of party influence: average FTRs rose irrespective of party, except under Thatcher. However, we see that although the FTR on £2,000 rose, it was lower on average under Tory governments. These observations suggest that Labour levied somewhat higher FTRs, but party discrepancies are hidden by the effects of fiscal drag (which could be treated as implicit government policy) and rising earnings.[3] Once we look at higher incomes, especially investment incomes, there is some suggestion that FTRs, on average, tend to be higher under Labour. The evidence is not entirely consistent, which is unsurprising given fiscal drag and macroeconomic constraints (eg the recessions of 1973–75 and 1979–81 probably induced 'above trend' FTRs).

It seems reasonable to conclude that, from 1948 to 1979, there was a fairly consensual view towards taxing earned incomes, but FTRs tended to be lower under Tory governments, economic conditions permitting. The discrepancy between the parties was more pronounced in respect of high, and investment, incomes, which were more heavily taxed under Labour. To the extent that this consensus existed, there is evidence that it has broken down under the recent Thatcher governments; FTRs have recently been decreased across the board, but the greatest reductions have been for investment incomes. The magnitude of these reductions reflects the revenue bouyancy

TABLE 1
Formal Tax Rates, married couple, 1948–86, Sample incomes and selected years

Government	Basic	Percentage FTR on sample incomes 2 × Basic	£2000	£5000	£10000(I)
LAB: 1948	10	21	21	31	49
AVE.	*10*	*21*	*21*	*32*	*51*
1951	10	23	23	36	54
CONS: 1952	8	19	19	35	55
AVE.	*10*	*21*	*19*	*30*	*53*
1964	12	21	19	25	53
LAB: 1965	13	22	20	27	56
AVE.	*14*	*23*	*21*	*28*	*58*
1970	15	23	21	27	58
CONS: 1971	14	22	22	28	60
AVE.	*16*	*23*	*20*	*28*	*57*
1973	18	23	20	28	57
LAB: 1974	20	26	23	32	60
AVE.	*21*	*27*	*24*	*34*	*64*
1979	18	24	21	29	54
CONS: 1980	19	24	21	30	55
AVE.	*18*	*24*	*21*	*30*	*50*
1986	17	23	19	28	41

SOURCES: Incomes based on RPI and a Wage Index (*Economic Trends*, 1986), and FTR estimated from *Inland Revenue Reports* (various years), as described in the text. All figures rounded. (I) designates Investment income.

generated by North Sea Oil revenues and privatisation, but it is the Thatcher government which has chosen to distribute the gains regressively.

Had our concern been to measure the direct tax burden, it would have been necessary to include National Insurance Contributions (NIC) as part of our tax rate. Although a discussion of the PIT does not require calculation of NIC rates, it would be desirable, and the main reason we do not incorporate NIC is because we were unable to obtain consistent NIC data compatible with our FTR data. There are a number of reasons why we do not believe the exclusion of NIC to detract from our argument.

First, there is no *a priori* reason, on the basis of stated party policies, to assume partisan influences on NIC over the period examined. Second, we have examined data on the burden of NIC, considering various measures, and have found no evidence of consistent party influences (*Social Trends*, 1973, 1983; *CSO Blue Books*) — nor did Karran (1985) in his econometric study. Third, our argument is most concerned with high incomes and investment incomes, which would not be affected by NIC. The principal effect of including NIC in our analysis would be to increase the tax rate on low incomes relative to high incomes.

Finally, it is likely that recent changes to NIC are consistent with the argument that the tax system has become more polarised under Thatcher. Inclusion of the recent increases in NIC would go some way towards eradicating the apparent reductions in PIT since 1981 for those on low to moderate earned incomes. The relative benefit to high and investment incomes is thus greater under Thatcher than our data suggest. A final point is that capital taxes are notably softer under Tory regimes (see Sandford, 1983) and have been watered down in recent years; again, a tax change of particular benefit to high earners.

Consumption taxes
Consumption taxes are 'invisible taxes' in which the burden of the tax is hidden in the cost of goods consumed. Whereas voter/taxpayers can observe income tax changes directly, changes in consumption taxes are difficult to isolate from market price fluctuations. Thus, the *political* value of changes in consumption tax policy is less significant than it is

for taxes which directly affect take home pay. At the same time, the lower visibility of consumption taxes gives them a very high *revenue value* so that when higher tax revenue is required they provide an automatic target. It would be politically rational behaviour for parties to use direct taxes for political ends while altering invisible taxes when they need to increase or maintain revenue.

Traditionally, the parties have held opposing views on consumption taxes but these have not been as clear as their positions on PIT. The Labour Party has long held that consumption taxes are inherently regressive (because the poor consume a greater percentage of their income than do the rich) and ought to be cut. On the other hand, as Barnett (1982) and Stewart (1977) have demonstrated, ministers face a dilemma: if revenue desired for increased spending exceeds that which comes naturally from inflation or economic growth, the money must come from either visible direct taxes or invisible indirect taxes. Party activists oppose indirect tax increases and voters oppose direct tax increases. When more tax revenue is required and income tax rates are already high, taking it directly from voters' pockets in direct taxes can be political suicide. Raising the revenue indirectly can be substantially easier.

The Tories have also taken a somewhat unclear stand on consumption taxes. Although arguing that *all* taxes should be reduced, they have generally focused on reducing income tax and have sometimes espoused a policy of shifting the tax burden from direct to indirect taxes. This policy has been most forcefully and directly championed by the Conservative Party since the early 1970s, especially under Mrs Thatcher (see below).

There are two types of taxes on goods and services in the UK: (1) Customs and Excise duties, which are unit taxes, ie the tax base is units of volume and the *duty is expressed in money terms*. Since the introduction of Value Added Tax (VAT) in 1973, excise duties have had an *ad valorem* element and are no longer simple unit taxes (this is why Table 2 ends in 1972); (2) a general sales tax, Purchase Tax until 1973 and VAT since then, which is *ad valorem*, ie the tax base is money value and the tax is expressed in percentage terms. We will discuss each tax separately.

1. *Excise duties*

All post-war British governments have raised excise duties. The duty on a bottle of beer, for example, is substantially more today than it was in 1948. While prices have increased dramatically, the excise taxes are based on *volume*, not prices, so that the effective tax rate, the duty as a percentage of the purchase price, may have decreased over the same period. This distinction is important because it affects how we evaluate policy changes. If we look only to nominal changes in duties we would be forced to conclude that neither party held true to their promises to reduce consumption taxes because nominal excise tax charges for most goods have increased under all governments (see Table 2). If we look closer, and examine effective tax rates, a different story emerges.

TABLE 2
Index of major Excise Duties and RPI, and cumulative change, 1948–72, (selected years)

	Dutiable Product					
Year	Oils	Tobacco	Beer	Spirits	Wine	RPI
1948 (L)	100.0	100.0	100.0	100.0	100.0	100.0
1951 (L)	333.3	100.0	86.3	100.0	100.0	111.6
1964 (C)	433.3	133.0	82.2	117.4	61.0	162.3
1970 (L)	600.0	173.3	116.0	178.8	108.5	216.8
1972 (C)	600.0	173.3	116.0	178.8	108.5	251.5
Cumulative change (%):						
Labour	400.0	40.3	20.1	61.4	41.5	66.1
Tories	100.0	33.0	−4.1	17.4	−39.0	85.4
Total	500.0	73.3	16.0	78.8	8.5	151.5

NOTES: Years are fiscal years. There were two wine duties; we only report the higher. Table stops in 1972 because these goods became subject to VAT in 1973.
SOURCE: *Customs and Excise Reports* (various years).

In order to estimate the effective tax rates, we look at changes in basic duties relative to the retail price index (RPI) measure of inflation. This method allows us to compare changes in overall prices with duty increases. Obviously, it would be more accurate to compare duty changes with the price trends for each dutiable good. This is not attempted here since the RPI is adequate for our purposes. Table 2 shows that for each good, except hydrocarbon oils, the RPI increased substantially more than duties. The evidence seems to corroborate the assertion of Robinson and Sandford (1983) that effective excise rates have fallen over the past four decades.

But do parties make a difference? For a clearer picture we turn to the lower part of Table 2, showing the total change in the basic duties between 1948 and 1972, distinguishing the cumulative change under each party. The data show that Labour increased the duties on all goods more than the Conservatives, even through the RPI rose faster while the Tories were in office. Overall, the effective rates tended to fall, but they fell more slowly during years of Labour rule.

It appears that Labour governments have not been true to their word, and have increased excise taxes even more than their Tory counterparts. Closer examination, however, reveals some of the pitfalls of interpreting statistical data outside of their historico-political context and drawing general conclusions (as Rose has done). Examining Table 2 again, we note that the duties which have been increased the most by successive Labour governments have been duties on items such as wine, spirits and hydrocarbon oils. Increases in these duties have been justified as taxes on 'luxury' goods by Labour chancellors and have been, in part, directed at making the tax system more progressive. This demonstrates that party changes to relative tax rates are intended to affect the distribution of the tax burden.

It is clear that parties have made a difference to the types and levels of excise taxes in Britain. Labour governments have not done exactly as promised and reduced these taxes in nominal (unadjusted) terms. But effective tax rates appear to have declined and, equally importantly, successive Labour governments have attempted to make the excise tax system more progressive. Tory governments, in contrast, have decreased nominal tax rates outright for some goods (beer and wine) and allowed effective tax rates to decline for all items we examine.

2. *Purchase tax*

Labour's dilemma with respect to consumption taxes (discussed above) can be observed in the history of general purchase taxes. The party rhetoric has been committed to reducing consumption taxes, believing that they are regressive, whereas these taxes have been increased by nearly every Labour government. Table 3 shows how Labour governments have increased purchase taxes across the board. As if to counteract the regressivity of these taxes, they establish extra tax rates for luxury items such as furs and perfume. The Table is simplified to three rates to represent the spread of rates on liable goods although there have been as many as five different rates at any one time.

Tory governments have simplified the rate structure and reduced purchase tax rates each time they assumed office between 1951 and 1972. The biggest reductions by Tory governments,

TABLE 3
Purchase Tax rates, 1948–72 (selected years)

YEAR	RANGE of RATES (%) Low	Medium	High
1948 (L)	33.3	66.7	100.0
1951 (L)	33.3	66.1	100.0
1964 (C)	10.0	15.0	25.0
1970 (L)	13.7	22.0	55.0
1972 (C)	11.2	18.0	25.0

NOTE: Zero rated and exempted goods excluded. The types of goods subject to each range and number of ranges varied.
SOURCE: Godwin (1975), Table 1.1, p. 10.

unsurprisingly, affected luxury items. Every postwar Labour government before 1972 increased purchase tax rates, introduced a graduated rate structure and increased rates on 'luxury' goods substantially above any increases in normally taxable items. We do not know the true incidence of this tax and cannot specify the degree to which these changes did affect progressivity. However, we can say that the *intent* of these governments was to alter the progressivity of purchase tax as well as the revenue from it (see Karran, 1985). The evidence suggests that parties have indeed made a difference.

3. *Value Added Tax*

Given its very short history, it would not be useful to present a table for VAT as we have done for other taxes. Since the Conservatives introduced VAT in 1973 the Labour Party has only been in government once. The experience to date suggests a polarisation of party tax policies unlike that which existed before the 1970's. With purchase tax the whole range of rates was higher under Labour; this pattern has not been repeated with VAT.

The Tories introduced VAT, in 1973, at a standard rate of 10% against strong Labour opposition. The Labour Party was very wary of VAT both because it was used to replace their Selective Employment Tax and because they believed that it would be very regressive (see Robinson and Sandford, 1983). The next Labour government did not abolish VAT; instead, they tried to make it progressive by reducing the standard rate to 8% and introducing an additional 25% rate for 'luxury' goods. (This luxury rate was subsequently reduced to 12.5% in response to demands from unions who believed that the high rate discouraged sales in their industries, especially electrical goods.)

Returning to power in 1979, the Tories quickly abolished the separate luxury rate and increased the standard rate to 15% while lowering the PIT rates on higher incomes. The Thatcher government promised to transfer the burden from direct to indirect taxes, and rarely does one find a government so effectively executing its tax policy. In 1978 income taxes accounted for 33.3% and VAT for 9.3% of total tax revenue. By 1985 the income tax share had fallen to 29.7% while VAT rose to 17.6% (*CSO Blue Book*, 1986).

The evidence does not permit us to explore the question of whether the incidence of consumption taxes has been more or less progressive under Labour or Tory governments. We do know, however, that every Labour government since the Second World War has attempted to make these taxes more progressive by disproportionately increasing the rates on 'luxury' items. The Tories, on the other hand, have consistently cut luxury rates thereby, at least implicitly, making consumption taxes more regressive. Having said this, it is clear that Labour governments have not been true to their campaign promises and have increased consumption taxes generally.

Only the post-1979 Tory government fits neatly into our hypothesised politically rational behaviour: political mileage was gained by reducing the visible PIT while revenue has been maintained by switching the burden to VAT. Earlier Tory governments had availed of economic growth to generate the revenue, and were able to reduce income and consumption taxes. Under Mrs Thatcher, they have availed of the bouyancy in other revenue sources (initially, the increase in VAT, then North Sea Oil and, most recently, Corporation Profits Tax). Labour, on the other hand, displayed a consistent tendency to increase tax rates, albeit in a progressive manner.

Corporation taxes

Corporate taxes have been a source of party conflict for much of the post-war era, but partisan effects on total revenue yield are absent (Karran, 1985). This does not imply that party influence is insignificant. While it is true that the Labour Party favours heavier taxation of corporate income than do the Tories, the complexity of this revenue source does not make for easy comparisons of their positions (nor for easy analysis of the tax, see Karran, 1985 and King, 1977).

Conservatives accept the revenue responsibilities of corporations, and Labour elites accept that capital accumulation is necessary for investment, growth and jobs in a mixed economy. The principal bone of contention between the parties has been the tax treatment of distributed and retained profits and it is here we would expect to find the greatest partisan effects. Labour has held that distributed profits should be taxed heavily because they are mostly paid out to rich shareholders and because these resources are better retained in growing companies which can generate employment. Tories consider this unfair, viewing it as double taxation. Moreover, they argue that such tax discrimination 'locks in' economic resources which could be used more efficiently elsewhere.

The first post-war Labour government taxed distributed profits at a much higher rate, 50% in 1951, than retained earnings, 10% (King, 1977). The Conservative government of 1952–64 more than halved these rates and eliminated the differential so that by 1964 there was only one profits tax at a 15% rate.

A separate Corporation Profits Tax was introduced in 1965 by the new Labour government which integrated the two systems of income tax and profits tax to which corporations had been subject since the war. One of the major justifications used by Labour in support of this reform was that the new tax would reintroduce the discrimination against distributed profits (Robinson and Sandford, 1983). They also increased the corporate tax rate.

Only one year after returning to office, in 1971, the Conservatives again reversed the discrimination against distributed profits. Chancellor Barber introduced a totally new 'integrated' corporate tax system, which gave shareholders a tax credit for profits taxes paid by the company, and reduced the rate of tax.

The next Labour government (1974) wished to reintroduce, yet again, the discrimination against distributed profits but was hesitant about repealing the latest Tory measures because of the dire economic difficulties which British corporations were facing at the time (Weisman, 1980). Instead the Corporation Profits Tax rate was increased from 42% to 52% and a new 'stock relief' tax allowance was introduced. Because of this measure: 'substantially the whole of the profits which a manufacturing company *continues to reinvest in its business*, whether by way of stock or plant, are effectively relieved from corporation tax' (Wilson Committee to Review the Functioning of Financial Institutions, quoted in Longstreath, 1981, p. 43, our emphasis). In short, Labour's traditional discriminatory policy had been reintroduced.

When the next Conservative government assumed office the reform of company taxation was not particularly high on the agenda. The party favoured mild taxation but, given the measures introduced by the last Labour government, there were few demands from the corporate sector for reducing the load further. Still, the system in effect favoured retained profits and this was unacceptable to the particularly ideological Thatcher government. Thus, the corporate tax system was re-reformed again in 1984. The latest measures were interpreted with some surprise in the national press because it was believed that corporate taxes may actually have been increased for some companies even though the corporate tax rate was reduced. An increase in effective tax rates appeared to violate the Thatcher government's general stance on taxation. In fact, these measures fit precisely into the general pattern described above. The major justification for the changes was that they would remove the tax discrimination against distributed profits.

Parties have made a substantial difference to the structure and rates of corporation tax. No one can know the final consequences of the various corporate tax policies pursued by different governments (ie whether they have stimulated or retarded corporate dividend and investment policies) but we do know that they have been substantially different and that these differences can be directly correlated with the party in power.

Do parties make a difference?

Rose's thesis is interesting because it challenges the traditional assumptions about the role of political parties in the democratic process. If parties make little or no difference we need to rethink our assumptions about representative democracy. The evidence on which Rose's and Karran's arguments are based is well documented: clearly there are things larger than parties. It is obvious that there are substantial constraints on government policy making, whether modelled as secular economic trends (Rose, 1984); world economic activity (Alt, 1986); or factors such as the power of bureaucracies and interest groups (Frey, 1984). Still, the existence of constraints does not necessarily imply that parties make no difference. If one wishes to test for partisan influences on policy outcomes, one must accept that constraints exist and allow for these in examining disaggregated data.

Aggregate statistical data, as used by both Rose and Karran, can provide us with useful information. However, such data can obfuscate the very question under examination. Parties rarely do everything that they promise, and almost always do things that they did not promise. Moreover, party positions are not frozen in stone and can change over time. Finally, important changes in public policy (such as the distribution of the tax burden within a particular revenue source) may not show up at all in gross revenue (or expenditure) statistics. None of these observations suggest that parties make little, or no, difference.

By using disaggregated tax data we have seen that Conservative governments tend to levy lower income tax rates, especially on the rich; they increase nominal rates of consumption tax less than Labour governments (the fundamental exception being the experience with VAT, see below) and encourage corporations to distribute their profits to shareholders. Even if inflation and economic growth continue to push tax receipts up, it is clear that Tory tax policies attempt to provide direct financial gains to their more affluent supporters.

Labour governments are more likely to increase PIT rates, particularly on the rich; consumption tax rates, especially on luxury goods; and to tax distributed corporate profits more heavily than profits which are reinvested. Labour governments may provide an ideological reward to their supporters by increasing the progressivity of the tax system, but they also tax all classes more heavily than do Conservatives. Direct rewards presumably come through public expenditure.

The partisan effects described in the previous two paragraphs hold generally from 1948 to 1979, and are weak for the PIT rates faced by the majority of taxpayers. All tax rates tended to be higher under Labour governments but the burden on the rich was relatively greater so that the tax system tended to be more progressive than under Conservative governments.[4] The polarisation between the parties, however, has been increased by the policies of the post-1979 Conservative government led by Mrs Thatcher. It is no longer true that the Conservatives reduce the tax rates they inherit from a Labour government. The 'Thatcher years' have seen the predictable lowering of income tax rates, but this has been combined with higher VAT, and NIC, rates. The effect has been to *increase* the burden of the tax system, and to distribute this burden more regressively.[5]

> 'The 1986 Budget has only had a slight impact on the distribution of income, although the gains that do exist rise with income. Households are worse off now than they would have been if the March 1979 tax and benefit system had been merely indexed. The few gains have accrued to the very rich and to those working and pensioner

households dependent on benefits. For the majority of the working population, the tax system has increased in severity over the last eight years' (Dilnot and Stark, 1986, p. 52).

Both parties have faced constraints, and neither has achieved all the tax goals which it set itself. Taxes have gone up during Tory regimes and the working class has been taxed more heavily under Labour. The Conservatives have not been able to unshackle the dynamic forces of capitalism through tax reforms, and the Labour party has not been able to fundamentally redistribute income and wealth in society.

Many important changes in the tax system are not explicitly related to partisan policies. In particular, the civil service has a reform agenda of its own which is not tied to party politics. These reforms — some major, others small and technical — can have a profound impact on the tax system and the distribution of the tax burden. Even in the case of 'apolitical' Treasury and Inland Revenue reforms, partisan effects are not absent. Numerous interviews we have conducted with officials from both departments have indicated that the civil service is acutely conscious of the 'political feasibility' of its reform proposals. Specific proposals can often 'sit on the shelf' for several years until a new government, which might be more amenable to the proposal, enters office.

The vagueness of some party goals, the constraints on government and the unexpected shocks which impose on all ruling parties, invariably mean that parties do not make the difference that some wish and others fear. This does not imply that they make no difference, nor that any differences are unimportant. We cannot know what tax policy would have been like had one party been in office for the entire period examined. But we do know that the switching back and forth between the parties has made a substantial difference. Voters are offered real choices, which broadly translate into specific public policies.

To evaluate the role of parties in British democracy, we have taken the case of the tax system and asked 'what difference do parties make, and to whom?'. The analysis was confined to tax rates but the evidence does suggest partisan influence on the distribution of the tax burden among voters. To the apolitical Treasury bureaucrat the findings may well be uninteresting. As Rose and Karran have already shown, both revenue and spending go up whichever party is in office. To students of political democracy, however, it is valuable to know that parties make a difference to the taxpayer/voters that elect them, and that they also make a difference to the tax system.

A postscript

'One of the most noticeable characteristics of the British tax system is that it is under continual change. Writing about it is very much like trying to hit a moving target' (James and Nobes, 1981, p. 135).

Two leading experts, John Kay and Mervin King, have described the British tax system as a 'mess' such that:

> 'Anyone who came to it for the first time would regard the present tax system with some incredulity... No one would design such a system on purpose, and nobody did. Only an historical explanation of how it came about can be offered as a justification. That is not a justification but a demonstration of how seemingly individually rational decisions can have absurd effects in aggregate' (Kay and King, 1983, p. 242–3).

Strong evidence now exists that the sorry state of the British tax system is a consequence of the shifts in tax policy between Labour and Tory governments (Steinmo, 1987). In particular, fault lies in the willingness of parties to tamper with the system without giving adequate thought to the consequences of their actions (Robinson and Sandford, 1983). The classic example is the haphazard frequency with which the corporate tax system has been changed (King, 1977; Hansard, 1979).

It has been argued that the level of taxation is less important than the rate at which it changes, and that tax reform ought to be approached with caution due to its destabilising effects (Head and Bird, 1983). It has also been shown that the instability of the British tax structure has almost certainly had negative effects on domestic investment and ultimately on growth (Weisman, 1980; Hansard, 1979; Pechman, 1980). Parties in government enact major reforms which are based more on ideology and political commitment than on rational analysis of the tax system and its many problems (Robinson and Sandford, 1983). Each party, when in opposition, *assumes* that the major problems with the system are a result of current government policy. Each party, when in office 'reforms' the system and attempts to undo the policies of the past government. The resulting layering of tax measures creates a complicated and often arbitrary system which neither contributes to social consensus nor collects revenue in anything approaching a rational manner.

When Schattschneider (1942) and other American writers looked so longingly at the British system of representative democracy it was not only the choice offered to voters which they admired but also the consensus building element of party government. Rose (1984) challenged the choice element in this view: if parties make little difference then the electoral choice is of little value. The evidence in this paper suggests that parties do make important differences, but that these are not necessarily conducive to consensus building.

Precisely because parties can make a difference, political conflict is sharpened. As economic choices become more difficult and the pieces of the pie grow more slowly, the tax system is subjected to even greater demands for, and attempts at, reform. Rather than aspiring towards the achievement of some form of grand consensus, the conflictual character of party government has, we believe, contributed to the complexity and inefficiency of tax policy-making in Britain.

In all democracies, parties compete for votes and make ideologically motivated promises. But, the British system of 'party government' allows the governing party more power to enact its campaign pledges than do most modern democracies. As a result policies can become unstable and, of equal importance, the incentives to reach compromise solutions which satisfice, and can be used for establishing consensus, are limited. Just as unstable tax policies can have serious economic consequences, policy solutions which ignore the opposition point of view can exacerbate political conflict. This can be seen in the polarisation of the tax system under Thatcher, which mirrors what some see as the polarisation of the nation into 'the haves, the have nots and the have lots' (Rentoul, 1987). Precisely because of the difference parties make in the UK, it is far from clear that the British model is the responsible democratic system American writers once believed it to be.

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NOTES

1. National Insurance Contributions have been omitted for reasons enumerated in the text. Capital taxes are omitted because partisan influences on capital tax policy are well documented and in line with our argument (Robinson and Sandford, 1983). As one expert has said: 'Capital taxes, the form they take, the weight of the tax, their coverage, indeed their very existence, are matters of party ideology' (Sandford, 1983, p. 36).
2. Prior to 1975, the *Inland Revenue Reports* published tables of 'Income Tax and Surtax: amount and effective rate of tax on specimen incomes'. These were used to calculate the FTRs on our sample incomes for 1948–74 inclusive. For the remaining years we calculated the FTR by applying the published tax rates to our sample incomes, less allowances. Clearly, the FTR is higher than the tax rate paid by most people since it does not account for those allowances which are not universal, in either their take-up or value (eg mortgage interest relief) or for the tax preference for income which can be classified as capital gains. In our view, the distribution of effective burdens has probably varied somewhat in line with the formal rates discussed in this paper; if anything, we over-estimate the rates on high relative to low incomes.
3. We also analysed the trend in FTRs on constant money incomes which confirmed that the increases in tax rates under Labour were primarily due to increases in nominal rates rather than fiscal drag.
4. For a rigorous attempt to assess the progressivity of the UK tax system between 1948 and 1982, applying two measures of progressivity to an aggregate model of the system, see Dilnot, Kay and Morris (1985). Their results suggest that progressivity fell between 1953 and 1968, rose thereafter and peaked around 1978, and tended to be greater under Labour governments.
5. Other relevant tax changes over this period were the abolition of investment income surcharge and successive relaxations of the Capital Tax regime. Proposals, at the time of writing, to replace domestic rates with a 'community charge' and to extend VAT to food (admittedly an EEC policy) would further increase the regressivity of the tax system.

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