

# **‘The pragmatist’s solution to poverty’: The Heath government’s Tax Credit Scheme and the politics of social policy in the 1970s**

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**Abstract:** The ‘rediscovery of poverty’ in mid-1960s prompted a wide-ranging debate over how the British government could best support low-paid workers and their families. Historians’ attention has largely focussed on the formation of the Child Poverty Action Group and its long campaign to persuade Harold Wilson and James Callaghan’s Labour governments to introduce a universal Child Benefit. The most radical response to the poverty problem, however, came from the Conservative government led by Edward Heath, which published plans to replace the whole system of personal tax allowances with reversible tax credits. This article examines the origins of the Heath government’s Tax Credit Scheme, which promised to both reduce the cost of tax administration and alleviate the ‘poverty trap’ created by means-tested benefits such as Family Income Supplement. It argues that the development of the Tax Credit Scheme in 1971-72 signalled the abandonment of the selectivity agenda with which the Conservatives had taken office in 1970, and so can be seen as one of Heath’s many ‘U-turns’. As the plans took shape, however, the cost of introducing the reforms on a no-losers basis became a source of growing concern within government. Treasury officials were relieved when Labour’s victory in the February 1974 election made it possible to jettison the scheme and retain the cumulative PAYE system.

**Keywords:** Heath government, Conservative Party, family poverty, income tax, child benefit

## **‘The pragmatist’s solution to poverty’: The Heath government’s Tax Credit Scheme and the politics of social policy in the 1970s**

On 10 October 1972 the Conservative Chancellor of the Exchequer, Anthony Barber, and the Secretary of State for Social Services, Sir Keith Joseph, unveiled plans for the most radical overhaul of Britain’s tax and benefits systems since the Second World War. The government’s Tax Credit Scheme, devised by Barber’s special adviser Arthur Cockfield, would dramatically simplify the income tax structure and turn the main personal allowances into reversible tax credits, providing an automatic and flexible form of income support for the low paid. The Tax Credit Scheme was intended to be both the capstone of Barber’s tax reform programme and a symbol of Joseph’s compassionate Conservatism – ‘the best talisman of the Government’s commitment to social justice in its reform of our antiquated tax system’.<sup>1</sup> Samuel Brittan, writing in the *Financial Times*, hailed it as ‘The biggest change since Beveridge’ and thought that ‘if [Edward Heath’s] Government is to be remembered in the history books it is more likely to be for this scheme... than for anything else’.<sup>2</sup> *The Times*’s economics editor Peter Jay also welcomed the reform, which showed that the UK Treasury was ‘the most talented and imaginative ministry of economics’ in the world, while the *Daily Mail* told its readers that ‘the Barber plan offers the best chance of helping the low-paid since the Welfare State began’.<sup>3</sup>

The Conservatives’ defeat in the February 1974 general election meant that the Tax Credit Scheme never came to fruition, and as a result it has attracted relatively little attention from historians.<sup>4</sup> The scheme is nevertheless of significant interest for a number of reasons. Firstly, it represents the most ambitious blueprint for income tax reform adopted by any post-war British government, and the only serious attempt to depart from the Pay-As-You-Earn (PAYE) system since it was introduced in 1944. Secondly, it was the most distinctive British contribution to the search for a workable Negative Income Tax which preoccupied policy-makers on both sides of the Atlantic during the 1960s and 1970s.<sup>5</sup> Thirdly, it formed a key part of the policy learning process which led from the ‘rediscovery of poverty’ in the mid-1960s to the introduction of Child Benefit in 1977 – a formative episode in the development

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<sup>1</sup> The quotation is from Patrick Jenkin, the Chief Secretary to the Treasury, in *Financial Times*, 11 Oct. 1972, 24.

<sup>2</sup> *Financial Times*, 11 Oct. 1972, 19.

<sup>3</sup> *The Times*, 11 Oct. 1972, 21; *Daily Mail*, 11 Oct. 1972, 6.

<sup>4</sup> The most detailed study is Leslie Lenkowsky, *Politics, Economics, and Welfare Reform: The Failure of the Negative Income Tax in Britain and the United States* (Lanham, NY, 1986), which draws heavily on contemporaneous interviews with policy-makers. The scheme is also discussed in outline in Rodney Lowe, ‘The social policy of the Heath government’, in Stuart Ball and Anthony Seldon (eds), *The Heath Government 1970-74: A Reappraisal* (Harlow, 1996), 191-214; Richard Whiting, *The Labour Party and Taxation: Party Identity and Political Purpose in Twentieth-Century Britain* (Cambridge, 2000); Maria Meyer-Kelly, ‘The Child Poverty Action Group 1965-1974: The Origins and Effectiveness of a Single Issue Pressure Group’, PhD thesis, University of Bristol, 2001; and most recently Florence Sutcliffe-Braithwaite, ‘Neoliberalism and morality in the making of Thatcherite social policy’, *Historical Journal*, 55 (2010), 497-520.

<sup>5</sup> The North American debate over Negative Income Tax is the subject of a growing literature. See especially Gareth Davies, *From Opportunity to Entitlement: The Transformation and Decline of Great Society Liberalism* (Lawrence, KS, 1996), and Brian Steensland, *The Failed Welfare Revolution: America’s Struggle Over Guaranteed Income Policy* (Princeton, NJ, 2008).

of the modern British welfare state.<sup>6</sup> Finally, it provides a valuable insight into the evolution of the Heath government's social and political strategy. Although the Conservative Party was determined to achieve greater 'selectivity' in the social services when it took office in 1970, the development of the Tax Credit Scheme marked a major shift away from means-tested benefits in response to the failure of the Family Income Supplement and widespread concern about the 'poverty trap'. Along with the 'Barber boom', the 1972 Industry Act, and Heath's statutory incomes policy, the Tax Credit Scheme came to symbolize the burial of 'Selsdon Man' and the government's reversion to a more inclusive brand of 'One Nation' Conservatism.<sup>7</sup> The failure of this centrist strategy in the 1974 elections sealed Heath's fate, and paved the way for a more fundamental break with the post-war settlement under Margaret Thatcher.

In comparison with the early post-war decades, detailed empirical work on the welfare state in the 1970s has been slow to emerge, though Pat Thane, Tanya Evans, Florence Sutcliffe-Braithwaite, and Gareth Millward have recently begun to remedy this deficiency.<sup>8</sup> This article draws on papers in the National Archives to examine the origins of the Tax Credit Scheme and set it in the context of the debates about social policy and social justice which followed the 'rediscovery of poverty'. As sociologist Robert Pinker pointed out at the time, the scheme represented 'the pragmatist's solution to poverty' – 'a welfare technician's paper' which provided a new mechanism for income redistribution without grounding it in any particular social philosophy.<sup>9</sup> In one sense, the scheme's technocratic ambition was characteristic of its era, and reflected the growth of a highly economistic form of 'poverty knowledge' in Whitehall and beyond.<sup>10</sup> At the same time, it was unusual in the extent to which it sidestepped the debate between left-leaning sociologists such as Richard Titmuss and the free-market Institute of Economic Affairs over the merits of 'universalism' and 'selectivity'.<sup>11</sup> As Robert Page has observed, '[p]ragmatic, evidence-based, expert-led policy... rather than pure "ideology" was the order of the day' under Heath's 'modern

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<sup>6</sup> The classic work on the child poverty debate is Keith Banting, *Poverty, Politics and Policy: Britain in the 1960s* (London, 1979).

<sup>7</sup> Although David Seawright has recently highlighted the ambivalence of the 'One Nation' tradition, I use it here as shorthand for that centrist strand of Conservative politics which stressed the capacity of elite leadership to defuse social conflict and unite the population around a shared national project. This was also how Heath used it, especially during the second half of his premiership. See David Seawright, *The British Conservative Party and One Nation Politics* (London, 2010), and Conservative Party, *For All the People* (London, 1972).

<sup>8</sup> Pat Thane and Tanya Evans, *Sinners? Scroungers? Saints? Unmarried Motherhood in Twentieth-Century England* (Oxford, 2012), esp. 140-68; Sutcliffe-Braithwaite, 'Neoliberalism and morality'; Gareth Millward, 'Social security policy and the early disability movement – expertise, disability, and the government, 1965-77', *Twentieth Century British History*, 26 (2015), 274-97.

<sup>9</sup> Robert Pinker, 'Social policy and social justice', *Journal of Social Policy*, 3 (1974), 1-19, at 15-16.

<sup>10</sup> Alice O'Connor, *Poverty Knowledge: Social Science, Social Policy, and the Poor in Twentieth-Century U.S. History* (Princeton, NJ, 2001), 213-41.

<sup>11</sup> Ben Jackson, 'Richard Titmuss versus the IEA: The transition from idealism to neo-liberalism in British social policy', in Lawrence Goldman and Stuart Jones (eds), *Welfare and Social Policy in British Historical Perspective, 1850-2010: Essays in Honour of Professor José Harris* (forthcoming).

technocratic Conservatism'.<sup>12</sup> Sutcliffe-Braithwaite has shown how Margaret Thatcher's election as Conservative leader heralded a shift towards a more ideological and moralistic conception of social policy, inspired by traditional family values and an individualist suspicion of the state.<sup>13</sup> However, the Thatcher governments' strategy of cutting taxes and benefits neither solved the poverty problem nor eliminated the 'poverty trap' which had caused so much concern in the 1970s.<sup>14</sup> Partly for this reason, the last thirty years have witnessed a revival of 'redistributive market liberalism' in the form of Norman Fowler's Family Credit, Gordon Brown's tax credit system, and Iain Duncan Smith's Universal Credit – policies which, in spirit though not design, have much in common with the Heath government's proposals.<sup>15</sup>

### **Competition with compassion: The Heath government's fiscal strategy**

The 1970-74 Conservative government came to power with the aim of bringing about what Edward Heath called a 'quiet revolution' in 'the outlook of the British nation'.<sup>16</sup> By curtailing state intervention, encouraging entrepreneurship, and making the British economy more flexible and dynamic, Heath hoped to achieve by free-market methods the faster economic growth that had largely evaded Harold Wilson.<sup>17</sup> Improving incentives to work, save, and invest by reducing direct taxation was central to this economic strategy. As Martin Daunton has pointed out, the Conservatives were also highly attuned to the political value of income tax cuts as a means of both satisfying their middle-class base and making inroads into Labour support among increasingly 'affluent' and tax-conscious skilled workers.<sup>18</sup> (Indeed, the party's private polling suggested that 'middle-aged manual workers' played a central role in Heath's surprise election victory.<sup>19</sup>) Heath and his colleagues recognized that lower direct taxation would have to be financed by higher indirect taxes and public spending cuts, but they hoped to maintain 'balance' and social cohesion by providing more selective support for disadvantaged groups. In Rodney Lowe's phrase, the Conservatives sought to combine

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<sup>12</sup> Robert M. Page, *Clear Blue Water? The Conservative Party and the Welfare State since 1940* (Bristol, 2015), p. 62.

<sup>13</sup> Sutcliffe-Braithwaite, 'Neoliberalism and morality'.

<sup>14</sup> Jonathan Bradshaw, 'Social security', in David Marsh and R.A.W. Rhodes (eds.), *Implementing Thatcherite Policies: Audit of an Era* (Buckingham, 1992), pp. 81-99.

<sup>15</sup> Julia Griggs, Andrew Hammond, and Robert Walker, 'Activation for all: Welfare reform in the United Kingdom, 1995-2009', in Ivar Lodomez and Amilcar Moreira (eds), *Activation or Workfare? Governance and the Neo-Liberal Convergence* (Oxford, 2014), 73-100. For the concept of 'redistributive market liberalism' see John Kay, 'Staking a moral claim', *New Statesman*, 11 Oct. 1996, pp. 18-20, and Samuel Brittan, 'Redistributive market liberalism', in Samuel Brittan, *Essays, Moral, Political and Economic* (Edinburgh, 1998), pp. 22-32.

<sup>16</sup> John Campbell, *Edward Heath: A Biography* (London, 1993), 311

<sup>17</sup> Brendon Sewill, 'A view from the inside: In place of strikes', in Ralph Harris and Brendon Sewill, *British Economic Policy 1970-74: Two Views* (London, 1975), 27-64; Sir Alec Cairncross, 'The Heath government and the British economy', in Ball and Seldon (eds), *The Heath Government*, 107-38.

<sup>18</sup> Martin Daunton, *Just Taxes: The Politics of Taxation in Britain, 1914-1979* (Cambridge, 2002), 302-28.

<sup>19</sup> Bodleian Library, Oxford, Conservative Party Archive (CPA), SC 10, SC/73/17, 'The Strategic/Tactical Situation in 1973', by Sir Michael Fraser and James Douglas, 14 Feb. 1973.

‘competition and compassion’.<sup>20</sup> The Tax Credit Scheme emerged in response to problems which the government encountered in implementing both parts of this package deal.

Tax reform was arguably the Heath government’s biggest success story, and one of the few major spheres in which it did not deviate from its original intentions. Both Heath’s first Chancellor, Iain Macleod, and Anthony Barber – who took over after Macleod’s untimely death in July 1970 – were more interested in fiscal policy than in broader economic matters, and hoped to leave a legacy as tax reformers.<sup>21</sup> In opposition, Macleod presided over the development of an elaborately modelled tax package which eventually came to revolve around the reduction of income tax and surtax, the abolition of Jim Callaghan’s Selective Employment Tax, and the replacement of purchase tax with a French-style Value Added Tax.<sup>22</sup> Barber largely implemented this package in his 1971 and 1972 budgets, and also unified income tax with surtax in a single graduated scale.

Alongside their commitment to reducing income tax, the Conservatives took a keen interest in the possibility of overhauling the system of collection. PAYE achieved relatively accurate deductions from cumulative earnings, minimising the need for end-of-year repayments and ensuring wide public support, but by the late 1960s it was widely held to have two major deficiencies. Firstly, its complexity made it expensive to administer, with 30,000 staff engaged mainly in generating codes and moving files from one local office to another. Partly for this reason, the Inland Revenue faced much higher administrative costs than countries with simpler systems, accounting for 1.45 per cent of the total tax yield in 1968/9 compared with the US Internal Revenue Service’s figure of just 0.4 per cent.<sup>23</sup> Secondly, PAYE was perceived to discourage work, because its cumulative system generated tax refunds when wages fell and made it difficult to deduct tax from unemployment and sickness benefits; backbench Conservative MPs were particularly agitated by this problem.<sup>24</sup> After the 1970 election, Barber commissioned the Inland Revenue to investigate the possibility of moving over to a non-cumulative system based on the US withholding tax. An interdepartmental working group eventually came down against this on the grounds that British taxpayers would find self-coding too complex and would resent having to wait for end-of-year repayments.<sup>25</sup> Non-cumulation nevertheless remained attractive to a government which was committed to reducing the size of the civil service and improving work incentives.

The other element of the Heath government’s fiscal strategy was the expansion of ‘selectivity’ in the social services. The underlying philosophy had been developed by Peter Goldman of the Conservative Research Department (CRD) in the 1950s: in an increasingly affluent society, Conservatives should seek to encourage private and voluntary welfare provision by the middle class and scale back the universal welfare state so that it increasingly

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<sup>20</sup> Lowe, ‘Social policy’, 198.

<sup>21</sup> Robert Shepherd, *Iain Macleod: A Biography* (London, 1994), 467-77, 526.

<sup>22</sup> CPA, CRD 3/7/6/3, EPG/66/85, ‘Economic Policy Group. Revised Report on the Reform of Taxation’, 30 May 1968, and CRD 3/7/26/37, folder A, paper 2, ‘Tax Package. The Development of Our Thoughts in Opposition’, 27 July 1970.

<sup>23</sup> The National Archives: Public Record Office, Kew (TNA: PRO), IR 40/17750, report on personal taxation in the United States and Canada (RETAX 2) by A.H. Dalton and W.M. Dermitt, n.d. [1970].

<sup>24</sup> TNA: PRO, IR 40/17749, ‘Working Group on Personal Taxation. Non-cumulative PAYE’, by A.H. Dalton, July 1970; T 328/878, Ralph Howell to Anthony Barber, 20 July 1973 (copy).

<sup>25</sup> TNA: PRO, T 171/882, ‘Report of the Working Group on Non-Cumulative PAYE’, draft summary by the Inland Revenue, 28 Oct. 1971.

became a means-tested safety net for the poor.<sup>26</sup> The party tended to shy away from the more radical implications of this doctrine, since it recognized voters' attachment to National Insurance benefits, state education, and the National Health Service, but the 'rediscovery' of family poverty by Brian Abel-Smith and Peter Townsend during the mid-1960s seemed to provide an ideal context in which to put it into practice. Using data from the Ministry of Labour's 1960 household expenditure survey, Abel-Smith and Townsend estimated that 2,000,000 people, including 600,000 children, lived in households with incomes below the basic National Assistance scales.<sup>27</sup> The left-leaning Child Poverty Action Group (CPAG) campaigned for child poverty to be alleviated by higher universal family allowances, but these were widely held to be unpopular with taxpayers, and if anything they became more so after the Wilson government increased their value but 'clawed-back' the gain from the better-off: 68 per cent of respondents to a May 1968 poll thought they should be confined to poor families.<sup>28</sup> As Barney Hayhoe of the CRD pointed out, means-testing family allowances would both allow them to be made more generous and free up resources for tax cuts.<sup>29</sup> CRD director Brendon Sewill supported this approach, and suggested using a Negative Income Tax mechanism – as popularized by Milton Friedman in *Capitalism and Freedom* (1962) – to avoid the stigma of traditional means-testing.<sup>30</sup>

The idea of replacing family allowances with a means-tested benefit figured prominently in Conservative thinking in opposition, but some senior figures became increasingly worried about its political implications. In particular, it was recognized that lower-middle-income families would lose out from the change unless the new benefit extended some way up the income spectrum – in which case the cost savings would be minimal.<sup>31</sup> Shadow Chancellor Iain Macleod was also keen to exploit CPAG's campaign against the Wilson government – with its controversial claim that 'The Poor Get Poorer Under Labour' – in the run-up to the 1970 election. Macleod therefore shelved the plan for a means-tested benefit in March 1970 and proposed to increase family allowances with clawback, pending the development of a workable Negative Income Tax.<sup>32</sup> The Tory manifesto accused Labour ministers of 'exaggerat[ing] the administrative problems involved' in tax-benefit integration and promised 'a real effort to find a practical solution'.<sup>33</sup>

Once the Conservatives were in office, however, they quickly realised that neither of these ideas was practicable. Treasury officials explained that, since the tax threshold was already relatively low, a further instalment of clawback would 'brin[g] into tax many of the people the extra [family allowance] is intended to help' whilst having little impact on child

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<sup>26</sup> See especially Peter Goldman's preface to Conservative Political Centre, *The Future of the Welfare State* (London, 1958).

<sup>27</sup> Brian Abel-Smith and Peter Townsend, *The Poor and the Poorest: A New Analysis of the Ministry of Labour's Family Expenditure Surveys for 1953-54 and 1960* (London, 1965).

<sup>28</sup> CPA, LCC 4/4, SP/70/8 – Addendum, 'Family Allowances', by Barney Hayhoe, 28 Jan. 1970.

<sup>29</sup> CPA, CRD 3/7/26/14, 'Family Poverty' by Barney Hayhoe, 14 Sept. 1967.

<sup>30</sup> CPA, CRD 3/7/26/10, Brendon Sewill to Charles Bellairs, Barney Hayhoe, Patten and Rosemary Marten, 'Social Service Policy', 6 Sept. 1968 (copy).

<sup>31</sup> CPA, CRD 3/7/26/41, James Douglas to Edward Heath, 'Selectivity', 20 May 1968; CRD, ACP 2/2, minutes of Advisory Committee on Policy meeting, 19 June 1968; Shepherd, *Iain Macleod*, 479-80.

<sup>32</sup> *Parliamentary Debates* (Commons), 799, 15 April 1970, 1391-1403, at 1400.

<sup>33</sup> Conservative Party, *A Better Tomorrow* (London, 1970), reprinted in *Conservative Party General Election Manifestos, 1900-1997*, ed. Iain Dale (London, 2000), 177-98, at 191.

poverty.<sup>34</sup> Likewise, it turned out that the case for Negative Income Tax had been rigorously examined in 1968 and 1969 by an interdepartmental working group. The problem was that the PAYE system was very poorly suited to paying out social benefits: its coverage of the population was too limited and it could not respond quickly enough to changes in family circumstances or earnings.<sup>35</sup> Both Sir Keith Joseph and Treasury ministers accepted that these objections were overwhelming.<sup>36</sup>

With clawback and Negative Income Tax closed off, Joseph reverted to the more conventional form of selectivity which the Conservatives had envisaged in opposition, and took up a proposal for a means-tested Family Income Supplement (FIS) which had previously been devised by Treasury officials.<sup>37</sup> This was introduced in August 1971, initially as a supplement to family allowances, though both ministers and officials hoped that it might subsequently be expanded into a ‘super-FIS’ to replace them.<sup>38</sup> Instead of breaking down public resistance to means-tested benefits, however, FIS became a serious embarrassment for the government. The need for claimants to apply to the Supplementary Benefits Commission limited take-up, so that after five months – in spite of an expensive publicity campaign – less than half of the eligible families were benefiting.<sup>39</sup> Critics also drew attention to the ‘poverty trap’ which FIS created for some workers when its 50 per cent withdrawal rate was superimposed on income tax and other means tests; one Treasury official felt that ‘the “marginal tax effect” is becoming politically quite as serious as... the number of families in poverty’.<sup>40</sup> CPAG director Frank Field and the Labour MP Michael Meacher waged an impassioned campaign against the benefit, whilst Conservative backbencher Enoch Powell likened it to the Speenhamland system of wage subsidies. Joseph was badly bruised by the

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<sup>34</sup> TNA: PRO, T 227/3121, N. Jordan Moss to Mr Henley, ‘Family Support’, 31 July 1970.

<sup>35</sup> TNA: PRO, CAB 134/3288, ‘Negative Income Tax. Report by a Working Group under the Chairmanship of the Chief Secretary to the Treasury’, and T 227/3132, M.F.H. Stuart to Mr Henley and Mr Mountfield, ‘Negative Income Tax’, 24 Sept. 1970.

<sup>36</sup> TNA: PRO, T 227/3121, Sir Keith Joseph to Maurice Macmillan, 22 July 1970, M.F.H. Stuart to Mr Jordan Moss, ‘Family Support’, 29 July 1970, and Maurice Macmillan to P. Mountfield, 6 Aug. 1970; T 227/3132, Maurice Macmillan to Sir Keith Joseph, 22 Oct. 1970 (copy).

<sup>37</sup> TNA: PRO, T 227/3121, Sir Keith Joseph to Maurice Macmillan, 22 July 1970.

<sup>38</sup> TNA: PRO, T 227/3121 Maurice Macmillan to P. Mountfield, 31 July 1970; T 227/3305, J.H. Gracey to Mr Wright, ‘Family Poverty’, 25 Feb 1971; T 227/3306, ‘Note of a Meeting held in Sir Douglas Allen’s Room at 3.00pm on Monday, 24 May’, by M.A. Cowdy, 27 May 1971 (copy); T 227/3307, Patrick Jenkin to Chief Secretary to the Treasury, ‘Review of Family Poverty’, 15 June 1971 (copy); British Library of Political and Economic Science (BLPES), London, Abel-Smith papers, 5/5, ‘Report of the Steering Group for Family Poverty Review’, June 1971.

<sup>39</sup> *The Times*, 22 Dec. 1971, 3.

<sup>40</sup> David Barker, ‘The family income supplement’, in David Bull (ed.), *Family Poverty: Programme for the Seventies* (second edition: London, 1971), 70-82; TNA: PRO, T 227/3525, M.F.H. Stuart to Mr Widdup, ‘Uprating of Pensions: Future Policy: Inter-relationship with Policy for Family Support’, 4 April 1972 (copy). P.R. Odgers of the Cabinet Office warned about the disincentive effect before FIS was introduced, but the Treasury did not think it would be too serious: TNA: PRO, T 227/3121, P.R. Oglesby to Mr Caldwell, ‘Supplementary Family Allowances’, 16 July 1970 (copy), and B.E. Fensome to Mr Jordan-Moss, ‘Family Income Supplement’, 7 Sept. 1970.

experience, and backed away from the idea of ‘super-FIS’ in the belief that the public would not stand it.<sup>41</sup>

The failure of FIS to provide a solution to family poverty compounded the government’s broader political difficulties during 1971 and 1972. Rising unemployment, trade union reforms, and spending cuts – including the withdrawal of subsidies for school milk and council house rents – left ministers open to charges of being doctrinaire and divisive, cutting taxes for the rich at the expense of the poor. Harold Wilson accused Heath of leading ‘the most reactionary Conservative Government in our lifetime’, and Labour opened up a large Gallup Poll lead in the course of 1971, peaking at 21.5 per cent in July.<sup>42</sup> The chairman of the Conservative Research Department, Sir Michael Fraser, warned that the government risked ‘becoming type-cast as “hard, efficient, and soulless”’, and Heath agreed that it was important to change these perceptions in order ‘to avoid being left too far behind on the polls’.<sup>43</sup> This was the context in which Heath launched his famous ‘U-turns’: reflating the economy, intervening in British industry, and introducing an incomes policy to control inflation.<sup>44</sup> It was also the context that produced the Tax Credit Scheme.

### **Arthur Cockfield’s brainchild, 1971-72**

The Tax Credit Scheme was the brainchild of Arthur Cockfield, a former Inland Revenue official and managing director of Boots whom Iain Macleod had taken into the Treasury as a special adviser. As part of his search for a replacement for PAYE, Cockfield began to play around with a proposal for a flat tax and a universal basic income which had been devised during the Second World War by Lady Juliet Rhys-Williams and was now championed by her son Sir Brandon, the Conservative MP for South Kensington.<sup>45</sup> The premise of Rhys-Williams’s scheme was very simple: if personal tax allowances were replaced with weekly cash payments or reversible tax credits, it would be possible to deduct basic-rate tax at source from all income on a non-cumulative basis. Rhys-Williams’s scheme had long been dismissed within Whitehall because she favoured a subsistence-level basic income, but Cockfield pointed out that it could work just as well with more modest payments.<sup>46</sup> He suggested that personal tax allowances should be replaced with weekly tax credits, worth perhaps £2.50 or £3 for each adult and £1.85 for each child, and tax levied at 30 per cent on all incomes up to a higher threshold of about £100 a week. Cockfield was determined to avoid subsidizing ‘the vagrants, the drifters, the drop-outs’, and unprofitable small businessmen, so he proposed to restrict the scheme to employees who paid Class I National

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<sup>41</sup> Andrew Denman and Mark Garnett, *Keith Joseph* (Chesham, 2001), 202-5; TNA: PRO, T 227/3307, ‘Note for the Record: Family Poverty Review’ by Malcolm Widdup, 24 June 1971.

<sup>42</sup> *Guardian*, 1 Nov. 1971, 5.

<sup>43</sup> CPA, SC 9, SC/71/5, ‘Public Opinion’ by Sir Michael Fraser, 13 Sept. 1971; SC 10, SC/71/8, minutes of Steering Committee meeting, 20 Sept. 1971.

<sup>44</sup> Campbell, *Heath*, 442.

<sup>45</sup> Juliet Rhys-Williams, *Something to Look Forward To* (London, 1943); Sir Brandon Rhys-Williams, *The New Social Contract* (London, 1967). For an analysis of Juliet Rhys-Williams’ original campaign see Peter Sloman, ‘Beveridge’s rival: Juliet Rhys-Williams and the campaign for basic income, 1942-55’, *Contemporary British History* (forthcoming).

<sup>46</sup> TNA: PRO, T 161/1461, ‘Notes on Income Tax reforms proposed in a book entitled “Something to look forward to?” by Lady Rhys Williams, and in a paper entitled “Income Tax in relation to Social Security”, by A.T. Haynes and R.J. Kirton, of the Institute of Actuaries’, by Inland Revenue, 16 July 1943; IR 40/17494, M.J.G. Elliott to Mr Andren, ‘Sir Brandon Rhys Williams’, 13 Feb. 1969.

Insurance contributions, together with widows and pensioners; with their families, these groups made up about 90 per cent of the population. On a 'no-losers' basis, with £3 adult credits, the scheme would cost about £1 billion.<sup>47</sup>

Cockfield was mainly attracted to the tax credit concept by the potential for simplification, since it would render coding unnecessary for most people and make it much easier to tax short-term benefits. At the same time, however, the scheme would provide an automatic form of income support for the low-paid, who could receive their unused tax credits in cash on a weekly basis. Employers would deduct tax from earnings at the standard rate, pay unused credits to workers along with the wage packet, and claim reimbursement where necessary from the Inland Revenue. Provided the credits were set at a high enough level, it would be possible to abolish family allowances and FIS for those within the scheme and greatly reduce reliance on Supplementary Benefit. Cockfield acknowledged that the credits themselves were unselective, but argued that 'the effect of the scheme is exactly and precisely the same as increasing the tax personal allowances combined with help to those below the tax threshold'.<sup>48</sup> The government could thus claim to have fulfilled its manifesto commitment to introduce a Negative Income Tax.

Cockfield submitted his blueprint to the Chancellor in August 1971, and it received a favourable reception from ministers and officials. Though the cost was a cause of some concern, the Financial Secretary to the Treasury, Patrick Jenkin, was 'enormously impressed' by the scheme's ingenuity, whilst Chief Secretary Maurice Macmillan thought it could be 'a satisfactory extension of the tax revolution' which Barber had already set in hand.<sup>49</sup> Sir Keith Joseph was worried about the exclusion of the self-employed and the uneven distribution of the benefits, but saw 'very great attractions from the social security point of view' in reducing the importance of means-tested benefits and alleviating the poverty trap.<sup>50</sup> Perhaps most importantly, the Inland Revenue chairman Sir Arnold France was attracted by the prospect of saving between 10,000 and 15,000 of the staff currently involved in PAYE work.<sup>51</sup> Whereas previous attempts at tax-benefit integration had been stymied by Revenue opposition, France became an enthusiast for the scheme and helped drive it forward. Barber authorized the formation of a full-time working group, chaired by the Inland Revenue official John Green, to examine Cockfield's proposals in detail and report before the 1972 budget. The working group endorsed the main principles of Cockfield's scheme with one exception: it felt his proposal to pay a full credit to housewives was much too generous, and instead suggested credit rates of £3 for a single person and £5 for a married couple, with the existing Wife's Earned Income Relief retained in a modified form.<sup>52</sup> The group agreed with Cockfield that self-employed people and workers below the Class I threshold of £8 a week would have to be excluded, the former because their weekly earnings were difficult to measure and the latter because of the risk of abuse; instead, they would continue to be taxed under PAYE and would

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<sup>47</sup> TNA: PRO, T 227/3335, 'The Negative Income Tax', by F.A. Cockfield, 2 Aug. 1971.

<sup>48</sup> Ibid.

<sup>49</sup> TNA: PRO, T 227/3350, Patrick Jenkin to Chancellor of the Exchequer, 'Negative Income Tax', 4 Oct. 1971 (copy); T 227/3335, M.V. Macmillan to Chancellor of the Exchequer, 'Mr Cockfield's NIT Scheme', 5 Oct. 1971 (copy).

<sup>50</sup> TNA: PRO, T 227/3350, Sir Keith Joseph to Anthony Barber, 1 Oct. 1971 (copy).

<sup>51</sup> TNA: PRO, T 227/3520, draft letter from Sir Arnold France to Chancellor of the Exchequer, 'TABS and the PAYE automation programme', 11 Nov. 1971 (copy).

<sup>52</sup> TNA: PRO, T 227/3521, TAB(SG)(72)5, 'TAB Steering Group. Financial and Budgetary Implications of the TAB Scheme. Note by Working Group', 21 Jan. 1972.

receive child support through FIS and an expanded child tax allowance.<sup>53</sup> Neither of these solutions was particularly elegant, but Green and his colleagues thought it best to set difficult cases aside in order to get the reforms off the ground. One academic observer, Leslie Lenkowsky, thought the group 'came as close to being partisans of the... scheme as the code of the British civil service would allow'.<sup>54</sup>

Although Green's working group reported in favour of the Tax Credit Scheme, Treasury officials were sharply divided over its merits. On the one hand, John Gracey of the Fiscal Policy Division was alarmed by the budgetary implications: not only would the initial cost have to be accommodated by spending cuts or tax increases, but the scheme would restrict future Chancellors' freedom of action by requiring a wide basic-rate band and making it harder to exploit fiscal drag.<sup>55</sup> The head of the Social Services Division, Malcolm Widdup, was similarly sceptical, pointing out that most of the cost was taken up by raising the tax threshold and that the gains would be least apparent to the very poor, for whom the credits would simply replace FIS and Supplementary Benefit.<sup>56</sup> Cockfield and the second permanent secretary Sir Samuel Goldman, however, turned these arguments upside down, emphasizing the political value of an across-the-board tax cut and suggesting that a more rigid tax system would be 'a useful disciplinary instrument for use against spending Ministers'.<sup>57</sup> On balance, the official Treasury advised the Chancellor to take the scheme forward.<sup>58</sup>

Barber had his own reservations about the details of the scheme, but he recognized its potential political value as a means of re-establishing the government's 'One Nation' credentials.<sup>59</sup> He therefore announced the proposal in his March 1972 budget speech and promised to publish a Green Paper which could be examined by a House of Commons Select Committee. Barber was keen to build a cross-party consensus around the policy, not least because the four-year lead-in time required by the Inland Revenue meant that it could not be introduced until mid-way through the next Parliament.<sup>60</sup> The Cabinet considered a draft Green Paper in June and 'agreed that the scheme would make a constructive and imaginative contribution to the Government's social policy', though publication was deferred because Barber's decision to let sterling float, on 23 June, made it an inauspicious time to announce new spending proposals.<sup>61</sup>

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<sup>53</sup> TNA: PRO, T 227/3520, TAB(SG)(71)1, 'Coverage of the TAB Scheme. Note by the Working Group', 10 Dec. 1971.

<sup>54</sup> Lenkowsky, *Politics*, 129.

<sup>55</sup> TNA: PRO, T 227/3520, J.H. Gracey (Treasury) to J.M. Green (IR), 7 Dec. 1971 (copy); T 227/3521, J.H. Gracey to Mr Hancock, Mr Beastall, and Mr Rogers, 'TABS', 26 Jan. 1972.

<sup>56</sup> TNA: PRO, T 227/3522, Malcolm Widdup to M.F.H. Stuart, 'TABS: Advantages and Disadvantages', 31 Jan. 1972.

<sup>57</sup> TNA: PRO, T 227/3523, 'Note of a Meeting held in Sir Douglas Allen's Office at 11.15 am on Friday, 11 February 1972', by D.C. Maughan, 15 Feb. 1972, and Sir Samuel Goldman to Sir Douglas Wass, 'TABS', 7 Feb. 1972.

<sup>58</sup> TNA: PRO, T 227/3523, Sir Douglas Wass to Sir Douglas Allen, 'Tax and Benefits Scheme', 18 Feb. 1972 (copy).

<sup>59</sup> Barber was particularly concerned about the exclusion of the very low paid and the self-employed: see TNA: PRO, T 227/3526, J.H. Gracey to Mr Maughan, 'Tax Credit Scheme', 17 May 1972 (copy).

<sup>60</sup> TNA: PRO, IR 40/17927, A.M. Bailey to Mr Unwin, 'Tax-Credit Scheme', 5 June 1972 (copy).

<sup>61</sup> TNA: PRO, CAB/128/50/33, Cabinet conclusions, 27 June 1972. Some departmental ministers also seem to have worried that the need to make room for the scheme would squeeze their spending allocations in the forthcoming PESC review: T 328/977, Sir Douglas

## The Green Paper and the Select Committee, 1972-73

The Green Paper on *Proposals for a Tax-Credit System* finally appeared on 10 October 1972 with a joint foreword by Barber and Joseph, hailing it as ‘a radical new approach’ to the integration of tax and social security ‘in which this country is leading the world’.<sup>62</sup> The paper outlined the scheme in detail on the basis of illustrative credits worth £4 for a single person, £6 for a married couple or a single parent, and £2 for each child. At a cost of £1.3 billion – approximately 2 per cent of GDP – the scheme would reduce income tax liability across the board, float about a million pensioners off Supplementary Benefit, provide a non-means-tested replacement for FIS, and substantially ease the poverty trap.

Barber and Joseph hoped that the Tax Credit Scheme would allow the government to put the FIS fiasco behind it and regain the initiative in social policy. After all, as Richard Whiting has pointed out, the successful introduction of such an innovative form of income support would have been a ‘major challenge’ to Labour’s claim to be the party of social justice.<sup>63</sup> The general thrust of the Green Paper was well-received by most commentators: Conservative newspapers praised ministers for devising a workable Negative Income Tax, whilst left-wingers such as CPAG director Frank Field welcomed the government’s apparent conversion to universalism.<sup>64</sup> Richard Titmuss commended the tax credit concept in a letter to *The Times*, and the former Labour minister Richard Crossman conceded that it represented a ‘notable breakthrough’.<sup>65</sup> Titmuss’s protégé Brian Abel-Smith went even further, arguing that the Green Paper proposals would ‘represent the largest single step forward in nearly universal provision for the poor and for social dependents since the post-war developments stemming from the Beveridge Report’.<sup>66</sup>

Within days of the Green Paper’s publication, however, the proposals began to attract criticism on a variety of grounds. Perhaps most serious was the Shadow Chancellor Denis Healey’s charge that the scheme was ‘a gigantic confidence trick’ because the government refused to give any indication of how it would cover the cost.<sup>67</sup> The Green Paper suggested that it could be financed by the proceeds of economic growth, but *The Guardian* thought that this came ‘dangerously near the Micawber tradition’ (‘something will turn up’).<sup>68</sup> If growth did not materialize, the scheme would have to be paid for by a higher basic rate of tax, higher VAT, or spending cuts elsewhere, in which case its social impact was much less certain. Frank Field and the economist Tony Atkinson highlighted the opportunity cost, arguing that a ‘back-to-Beveridge’ approach of increasing family allowances and National Insurance benefits would have a larger and more immediate impact on poverty.<sup>69</sup> Field also criticized

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Wass to Mr Corlett, ‘Cabinet: Proposals for a Tax-Credit System – CM(72)61’, 21 June 1972 (copy).

<sup>62</sup> Cmnd. 5116, *Proposal for a Tax-Credit System* (London, 1972), iii.

<sup>63</sup> Whiting, *Labour Party*, 225.

<sup>64</sup> *Daily Telegraph*, 11 Oct. 1972, 18; *Daily Mail*, 11 Oct. 1972, 6; *Tribune*, 13 Oct. 1972, 3.

<sup>65</sup> *The Times*, 1 Nov. 1972, 14, and 14 Oct. 1972, 17.

<sup>66</sup> *Parliamentary Papers*, 1972-73, vol. 34, ‘Select Committee on Tax Credit: Volume II – Evidence’, 349-58, at 358.

<sup>67</sup> *The Times*, 11 Oct. 1972, 1.

<sup>68</sup> *Guardian*, 11 Oct. 1972, 12.

<sup>69</sup> A.B. Atkinson, *The Tax Credit Scheme and the Redistribution of Income* (London, 1973); TNA: PRO, T 227/3999, ‘Implications for Families of Proposed Tax Credit Scheme. Paper given by Frank Field, Director of Child Poverty Action Group, at Conference held on 29<sup>th</sup> November, 1972 [by the] British Union of Family Organisations’.

the exclusion of the self-employed, and pointed out that the abolition of family allowances would leave those outside the scheme *more* reliant on means-tested benefits.<sup>70</sup> From the opposite perspective, George and Priscilla Polanyi of the Institute of Economic Affairs called on the government to return to its original, selectivist conception of Negative Income Tax.<sup>71</sup>

Alongside the scheme's £1.3 billion price tag, public criticism focussed on the proposals for child credits. The Green Paper left open the question of whether these would be paid to the father or the mother, but it strongly hinted that the former option was preferable because it would minimize administrative costs. Civil servants were also keen on payment to fathers because it would increase rather than reduce men's take-home pay, and so help moderate wage demands.<sup>72</sup> As Barber had feared, however, the suggestion that mothers might lose their family allowances provoked a storm of protest from CPAG and women's groups.<sup>73</sup> More than 300,000 people signed petitions in favour of payment to the mother, and the veteran Labour peer Edith Summerskill led a cross-party assault on the government in the House of Lords.<sup>74</sup> In the face of these protests Barber began a tactical retreat, using his March 1973 budget speech to indicate that the government would not allow mothers to be made worse off.<sup>75</sup> The Select Committee went further by recommending that the whole credit should be paid to the mother and that child credits should be available to all families, including the self-employed.

A third point of controversy was the Green Paper's proposal to retain PAYE for working wives instead of giving them a full credit. Not only did the National Council of Women, the Conservative Women's Advisory Committee, and the quasi-official Women's National Commission object to this on feminist grounds, but the Confederation of British Industry protested that employers could not be expected to operate two separate tax systems.<sup>76</sup> The Select Committee proposed that working couples should be allowed to opt for two £4 single credits, and the government promised to investigate the idea. However, the working group concluded that this would be administratively impossible with manual records, so the Green Paper approach would have to be followed until the Inland Revenue was fully computerized.<sup>77</sup>

A final set of criticisms, voiced especially by the Labour Party, focussed on the scheme's implications for the wider tax system. Though many of Labour's social policy

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<sup>70</sup> Ibid.

<sup>71</sup> George and Priscilla Polanyi, 'Tax credits: A reverse income tax', *National Westminster Bank Quarterly Review* (Feb. 1973), 20-34.

<sup>72</sup> TNA: PRO, T 227/3526, M.A. Johns to Mr Corlett, 'GEN 112(72)5. Tax-Credit Scheme: Draft Green Paper. Payment of Child Credits to Father or Mother', 25 July 1972.

<sup>73</sup> TNA: PRO, T 227/3523, J.H. Gracey to Mr Maughan, 'Treatment of the Family in the TABS Scheme', 7 Feb. 1972.

<sup>74</sup> *Parliamentary Papers, 1972-73*, vol. 34, 'Select Committee on Tax Credit: Volume I – Report and Proceedings of the Committee', 20; *Parliamentary Debates (Lords)*, 338, 24 Jan. 1973, 157-205.

<sup>75</sup> TNA: PRO, T 328/874, A.M. Bailey to Miss Seammen, 'Tax Credit Scheme: Child Credits', 18 Dec. 1972 (copy); T 227/3999, Anthony Barber to William Clark, 8 March 1973 (copy).

<sup>76</sup> TNA: PRO, T 227/3999, R.R. Martin (to Mr Corlett, 'Report by the Women's National Commission on the Tax-Credit Scheme', 6 April 1973; Modern Records Centre, University of Warwick, Confederation of British Industry papers, MSS.200/C/3/EMP/5/8, L.92.73, 'Tax Credits. CBI Evidence to the Select Committee' by D.M. Rea, 14 March 1973 (copy).

<sup>77</sup> TNA: PRO, T 227/3999, R.R. Martin (IR) to Mr Corlett, 'Tax Credit Scheme: Treatment of Married Women', 31 July 1973 (copy).

advisers were enthusiastic about tax credits in principle, the party's tax experts were much more sceptical: in particular, Nicholas Kaldor argued that Green Paper version would "freeze" the income tax system into a mould which reduces it to a simple proportionate tax for all but the highest earners, erecting 'a firm and lasting barrier to progressive taxation'.<sup>78</sup> The possibility that tax credits would subsidize low wages also aroused hostility from Labour MPs and trade unionists: Barbara Castle, for instance, declared that wage subsidies were 'repugnant in a modern society'.<sup>79</sup> These criticisms meant that the Select Committee split on party lines, with three of the four Labour members – Castle, Joel Barnett, and Robert Sheldon – opposed to the scheme and only Douglas Houghton and the Liberal MP John Pardoe giving it qualified support.<sup>80</sup> In the end, the government had to rely on the built-in Conservative majority to secure a favourable verdict.

### **'Doing Something For Everyone', 1973-74**

By the time the Select Committee completed its work in July 1973, the Tax Credit Scheme had lost much of its original gloss, as concerns about cost and the payment of child credits allowed critics to question whether it was really a progressive measure. It was clear that the government could only go forward with the scheme if it paid child credits to the mother, but the resulting reduction in pay packets would be at odds with the Conservatives' desire 'to promote a greater sense of personal responsibility on the part of the individual wage-earner'.<sup>81</sup> At the same time, Treasury officials had revised their cost estimates upwards and were now convinced that the scheme would require countervailing tax rises – either increasing the basic rate of income tax to 34 per cent or more than doubling VAT – to pay for it.<sup>82</sup> Finally, modifications to the Green Paper design had eroded some of the projected staff savings.<sup>83</sup> The permanent secretary at the Treasury, Sir Douglas Allen, pointed out that it was 'very much a political decision for Ministers, whether to proceed with the scheme in the face of the Opposition's hostility', and the junior Treasury minister John Nott – who was uneasy about the government's broader economic strategy – also sounded a note of caution.<sup>84</sup> Though Nott was 'naturally incline[d]... to press forward' with the scheme, he felt it raised 'far reaching policy issues for the Conservative Party in the mid-70s and beyond' and worried

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<sup>78</sup> *Parliamentary Papers*, 1972-73, vol. 34, 'Select Committee on Tax Credit: Volume II – Evidence', 211-37, at 212, 217.

<sup>79</sup> *Parliamentary Papers*, 1972-73, vol. 34, 'Select Committee on Tax Credit: Volume I – Report and Proceedings of the Committee', 77-84, at 82.

<sup>80</sup> TNA: PRO, T328/877, J.H. Gracey to Mr Jones, 'Select Committee on the TCS', 27 June 1973 (copy).

<sup>81</sup> TNA: PRO, CAB/128/52/37, Cabinet conclusions, 17 July 1973.

<sup>82</sup> TNA: PRO, T 328/872, 161. D.W.G. Wass to Sir Douglas Allen, 'Phasing in the Tax Credit Scheme', 10 July 1973 (copy), and T 328/873, 'Working Group on Phasing-In the Tax Credit Scheme. Report of the Working Group', 6 July 1973.

<sup>83</sup> In addition to the extra cost of paying child credits to the mother, the CBI had insisted that the Inland Revenue should continue to send tax codes directly to employers: see TNA: PRO, T 328/1147, 'Tax Credit Scheme', draft brief by A.J.G. Isaac, Somerset House, 26 Sept. 1974.

<sup>84</sup> TNA: PRO, T 328/877, Sir Douglas Allen to Mr Bailey, 'Report by the Select Committee on Tax Credit', 29 June 1973 (copy).

about getting into ‘a situation in which we were having to defend both before and through an election a scheme which had no instinctive support in the country’.<sup>85</sup>

Barber recognized that it was a finely-balanced decision, especially in the context of a mounting budget deficit, but in the end he was more impressed by the political dangers of dropping the scheme.<sup>86</sup> ‘To abandon it at this stage’, he warned the Cabinet,

would leave the Government without a comprehensive strategy in these important areas of social and fiscal policy, and would be liable to reopen questions about family support, provision for the elderly and the taxation of short-term benefits, the last of which was a question of particular concern among the Government’s supporters.<sup>87</sup>

Other ministers felt that ‘the Government stood to gain substantial political credit from proceeding with the scheme’ and pointed out that its cost could be phased.<sup>88</sup> With Cabinet approval, Barber announced on 19 July 1973 that the government would go ahead with the scheme on the basis of universal child credits paid to the mother.<sup>89</sup> Preparations went forward with a view to including legislation in the 1974 Finance Bill, introducing child credits in April 1976, and completing the changeover two years later. After some wrangling, it was agreed that the Inland Revenue and Department of Health and Social Security (DHSS) would be jointly responsible for implementation. The Treasury also agreed to treat the credits as deductions from revenue rather than additional public expenditure – a major departure from traditional accounting conventions.<sup>90</sup>

Having invested so much political capital in the Tax Credit Scheme, Heath and Barber hoped to yield the benefit in the run-up to a 1974 or 1975 general election. The government briefed that ministers saw the scheme as ‘a major vote winner, with a particular appeal to women voters’, especially now that child credits would be paid to the mother, and Heath’s public relations adviser Michael Wolff thought ‘it ought to be a feather in our election manifesto’.<sup>91</sup> Together with rising spending on existing services such as health and education, and well-publicized *coups de theatre* such as a £10 Christmas bonus for pensioners, the tax credit proposals symbolized the government’s determination to ensure that the benefits of growth were widely shared: as the party’s 1973 advertising campaign put it, the Conservatives were ‘Doing Something For Everyone’.<sup>92</sup> Polling suggested that these new

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<sup>85</sup> TNA: PRO, T 328/878, John Nott to Chancellor of the Exchequer, ‘Report by the Select Committee on Tax Credits’, 2 July 1973 (copy). For Nott’s reservations about the Heath government’s policies, see John Nott, *Here Today, Gone Tomorrow: Recollections of an Errant Politician* (London, 2002), 123-63.

<sup>86</sup> Nott later confessed to Joseph that ‘Tony Barber (perhaps unknown to you!) was hesitating about including it in PESC way back in 1973, as we then reckoned that it was going to cost about £2,500m’: see CPA: KJ 10/21, John Nott to Sir Keith Joseph, ‘Tax Credits’, 25 June 1975.

<sup>87</sup> TNA: PRO, CAB/128/52/37, Cabinet conclusions, 17 July 1973.

<sup>88</sup> *Ibid.*

<sup>89</sup> *The Times*, 20 July 1973, 1.

<sup>90</sup> TNA: PRO, T 328/976, TCM (74) 1<sup>st</sup> Meeting, minutes of Ministerial Group on Tax Credits, 11 Jan. 1974.

<sup>91</sup> *Guardian*, 31 Oct. 1973, 1; Churchill Archives Centre, Cambridge, Michael Wolff papers, 3/3/78, Michael Wolff to Lord President of the Council, ‘Tax Credit Scheme’, 27 Feb. 1973 (copy).

<sup>92</sup> CPA, SC 11, SC/73/21 ‘Manifesto Themes’ by Tony Newton, 18 July 1973.

welfare policies had some impact on voters, and helped the government regain support as the election approached. For instance, the Conservatives overtook Labour as the party best able to handle pensions – though Tory strategists admitted that Labour still had ‘an enormous advantage on “heart” issues more generally.’<sup>93</sup>

With the onset of recession in the winter of 1973-74, however, the Tax Credit Scheme turned from an asset into a liability. In the crisis atmosphere of the February 1974 election, Heath’s tough line against the miners cast social policy into the shadows and reinforced perceptions that the government was ‘divisive’ and ‘bloody-minded’.<sup>94</sup> Not only did the Conservatives struggle to arouse interest in tax credits, but Denis Healey was able to use their cost to deflect criticism of Labour’s own spending plans.<sup>95</sup> Whitehall officials became increasingly convinced that the Green Paper proposals were unaffordable, and warned the incoming Chancellor that even a scaled-back version would pose ‘a very significant budgetary problem’.<sup>96</sup> When Labour took office, Healey duly scrapped the scheme, retaining only the child credit proposals under the title of Child Benefit.

### Afterlife

The Heath government’s defeat and the collapse of the long post-war boom dealt a death blow to Cockfield’s grand design. The bleak economic climate of the late 1970s made the full Tax Credit Scheme seem impossibly extravagant, and both the main parties became more sceptical about technocratic solutions to poverty. By rejecting the Tax Credit Scheme and maintaining PAYE, the Wilson and Callaghan governments were able to revive Labour’s traditional fiscal strategy of making income tax more progressive whilst raising additional revenue through fiscal drag.<sup>97</sup> On the social security side, Barbara Castle and David Ennals pursued the ‘back-to-Beveridge’ approach favoured by CPAG and trade union leaders such as Jack Jones: improving National Insurance, replacing family allowances with Child Benefit, and creating SERPS as an earnings-related addition to the state pension.<sup>98</sup> Brian Abel-Smith, who advised Castle at the DHSS, argued that this focus on universal benefits was expensive and would leave many poorer families and pensioners reliant on means-testing for the foreseeable future.<sup>99</sup> However, neither the government nor the Labour Party showed much

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<sup>93</sup> David Butler and Dennis Kavanagh, *The British General Election of February 1974* (London, 1974), 56, 140; CPA, CCO 180/27/9/4, PS/73/4 ‘Summary of the Opinion Research Centre’s Survey on Party Images (Fieldwork – 22<sup>nd</sup>-26<sup>th</sup> August 1973)’ by DJN/JWF, 9 Oct. 1973. See also Patrick Cosgrave, ‘Taking the machine apart’, *The Spectator*, 20 April 1974, 470-1.

<sup>94</sup> Ivor Crewe, Bo Särilvik, and James Alt, ‘The why and how of the February voting’, *New Society*, 12 Sept. 1974, 669-72, at 670.

<sup>95</sup> *Guardian*, 14 Feb. 1974, 8.

<sup>96</sup> TNA: PRO, T 328/1147, ‘Tax Credit Scheme.’ Note by Somerset House, 28 Feb. 1974 (copy).

<sup>97</sup> Whiting, *Labour Party*, 246-58; Tom Clark, ‘The Limits of Social Democracy? Tax and Spend under Labour, 1974-79’, Institute of Fiscal Studies Working Paper 01/04, Jan. 2001.

<sup>98</sup> Polly Toynbee and David Walker, ‘Social policy and inequality’, in Anthony Seldon and Kevin Hickson (eds), *New Labour, Old Labour: The Wilson and Callaghan Governments, 1974-79* (Abingdon, 2004), 105-22; Helen Fawcett, ‘Jack Jones, the Social Contract and social policy 1970-4’, in Helen Fawcett and Rodney Lowe (eds), *Welfare Policy in Britain: The Road from 1945* (Basingstoke, 1999), 158-83.

<sup>99</sup> TNA: PRO, IR 40/18565, Barbara Castle to Denis Healey, 15 May 1974 (copy), and NIT(74) 1<sup>st</sup> Meeting, ‘Note of Meeting on Thursday 13 June 1974 in the Board Room,

interest in Abel-Smith's efforts to devise a more progressive version of the Cockfield scheme.<sup>100</sup>

The Conservatives reiterated their support for tax credits in the October 1974 election, but after Margaret Thatcher became leader in January 1975 the party's commitment began to waver.<sup>101</sup> As Peter Dorey has shown, Thatcher and her allies on the New Right tended to reject the concept of relative poverty which had come to the fore in the 1960s and to see poverty largely in pathological terms: 'residual poverty (to the extent that its existence was acknowledged) was either attributable to the dysfunctional character of the welfare state itself, or was due to the individual failings of a minority of individuals'.<sup>102</sup> Thatcher's belief in the Protestant work ethic made her suspicious of the 'fashionable fallac[y]... that there is no real difference between a tax relief and a cash subsidy or benefit', and she worried (as Joseph explained to colleagues) that tax credits would lead to 'the reinforcement of the "transfer machine"', 'removal of the motive to personal thrift' and 'the further socialisation of income'.<sup>103</sup> Over time, these doubts came to be shared by previously enthusiastic allies such as the Shadow Chancellor Sir Geoffrey Howe – who explained that he had 'become increasingly wary of reform proposals which involve some single moment of massive institutional change' – and Joseph himself.<sup>104</sup> Even Cockfield worried that the scheme could 'be converted into an engine for a major extension in the welfare state' and felt that the separate introduction of Child Benefit had substantially reduced its political value.<sup>105</sup> Tax credits 'lived on in a strange half-life through Thatcher's opposition period' – as Florence Sutcliffe-Braithwaite has noted – partly because the social security spokesman Patrick Jenkin saw them as the best way of reducing pensioner poverty, taxing short-term benefits, and dealing with the poverty trap.<sup>106</sup> Howe and the Treasury team, however, were increasingly

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Somerset House. Working Group on Negative Income Tax', by M. Symons, 17 June 1974; British Library of Political and Economic Science, London, Brian Abel-Smith papers, 7/11, Brian Abel-Smith to Mr Radford and Mr Overend, 'Cost of Improvements in Social Security and Related Benefits', 29 July 1975 (copy).

<sup>100</sup> Abel-Smith papers, 7/11, Bryan Ellis to Brian Abel-Smith, 'Planning for 1980-85', 14 Nov. 1975 (copy); RE 382, 'Costed Options for Social Security', by Brian Abel-Smith, Dec. 1975; RE 388, 'Costed Options for Social Security – Michael Meacher's Comments', 8 Dec. 1975; RE 417, 'Future Social Security Strategy', by David Piachaud, Jan. 1976; and Labour Party Social Policy Sub-Committee, minutes of ninth meeting, 9 Dec. 1975.

<sup>101</sup> The October 1974 Conservative manifesto described the scheme as 'the centre-piece of our social programme' and promised to bring it into effect 'in stages, as economic circumstances permit': Conservative Party, *Putting Britain First* (London, 1974), reprinted in *Conservative Party General Election Manifestos*, 229-61, at 246.

<sup>102</sup> Peter Dorey, *British Conservatism: The Politics and Philosophy of Inequality* (2011), p. 137.

<sup>103</sup> CPA, CRD 3/7/26/14, 'Tax relief – or cash subsidy?' by Margaret Thatcher, *Building Societies Gazette* (October 1967); CRD 4/7/14, 'Taxation and Social Security. Record of a meeting held on Tuesday, 12<sup>th</sup> December, 1978 at the House of Commons', by P.J. Cropper, 3 Jan. 1979 (copy).

<sup>104</sup> *Guardian*, 26 Jan. 1976, 10.

<sup>105</sup> CPA, CRD 4/7/14, 'Pensioner Credits. Mr. Mockler's suggestion for a partial pensioner credit', by Arthur Cockfield, 8 March 1979; CRD 4/7/13, 'Personal Tax Policy – The Alternative Approaches' by F.A. Cockfield, 18 Jan. 1978 (copy).

<sup>106</sup> Sutcliffe-Braithwaite, 'Neoliberalism and morality', 507; see also *New Society*, 21 July 1977, 148, and CPA, CRD 4/7/13, 'Minutes of a Meeting held on 11<sup>th</sup> June 1978 at 61, Fentiman Road', by Christopher Mockler, 16 June 1978.

adamant that the need to reduce taxation and cut the Public Sector Borrowing Requirement left no room for costly new initiatives.<sup>107</sup> By 1979 the idea had effectively been killed off, though the Conservative manifesto made a token reference to ‘the fulfilment of our original tax credit objectives as and when resources become available’.<sup>108</sup>

Where the Heath government had sought to tackle both poverty and welfare dependency, the Thatcher governments focussed squarely on the latter, playing on the very old categorical distinction between work and welfare. In particular, Thatcher’s ministers sought to improve work incentives by cutting income tax and making benefits less generous. Even in its own terms, however, this strategy achieved limited success during the early 1980s in the context of rising unemployment and a growing reliance on means-testing.<sup>109</sup> As a result, interest in tax-benefit integration persisted in various parts of the political spectrum. Some Conservative backbenchers still hankered after the Cockfield scheme, whilst the New Right economist Patrick Minford proposed a Friedman-style Negative Income Tax and Sir Brandon Rhys-Williams continued to press for a basic income.<sup>110</sup> The Institute of Fiscal Studies even showed how a mixture of tax and benefit credits could replace the entire social security system.<sup>111</sup> The path that was ultimately followed was the much more cautious one of expanding FIS, first into Family Credit in 1988 and then into Working Families Tax Credit after New Labour took office in 1997. Despite the name, Gordon Brown’s tax credits were modelled not on Cockfield’s scheme but on the US Earned Income Tax Credit, and simply paid a means-tested benefit through the tax system.<sup>112</sup> By 2010 the Labour government was spending £28 billion a year on tax credits, making them the second-largest element in the social security budget after the state pension. The current Conservative government is taking another step towards Negative Income Tax by rolling these and other means-tested benefits into Universal Credit.

## Conclusion

How, then, should the Tax Credit Scheme be remembered? It was certainly a product of its time: the short window between the mid-1960s and the mid-1970s in which British politicians both recognized the reality of relative poverty and believed they could do something about it. Where the Wilson government’s social security policy had descended into ‘confusion and incoherence’, Heath and his colleagues sought to draw on radical new

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<sup>107</sup> CPA, CRD 4/7/14, ‘Record of Meeting held on Friday 21<sup>st</sup> July 1978’, by P.J. Cropper, 24 July 1978 (copy), and ‘Taxation and Social Security. Record of a meeting held on Tuesday, 12<sup>th</sup> December, 1978 at the House of Commons’, by P.J. Cropper, 3 Jan. 1979 (copy).

<sup>108</sup> Conservative Party, *The Conservative Manifesto 1979* (London, 1979), reprinted in *Conservative Party General Election Manifestos*, 265-82, at 280.

<sup>109</sup> Andrew Dilnot and Graham Stark, ‘The poverty trap, tax cuts, and the reform of social security’, in Andrew Dilnot and Ian Walker (eds), *The Economics of Social Security* (Oxford, 1989), 169-78.

<sup>110</sup> CPA, CRD 4/4/200, ‘Tax and Social Security Policy Group’ report, 31 March 1983; Patrick Minford, ‘State expenditure: A study in waste’, supplement to *Economic Affairs*, 4, no. 3 (April-June 1984); Hermione Parker, *Instead of the Dole: An Enquiry into Integration of the Tax and Benefit Systems* (London, 1989).

<sup>111</sup> A.W. Dilnot, J.A. Kay, and C.N. Morris, *The Reform of Social Security* (Oxford, 1984).

<sup>112</sup> Jane Millar, ‘Tax credits’, in Jane Millar (ed.), *Understanding Social Security: Issues for Policy and Practice* (Bristol, 2009), 233-51.

ideas to reconstruct the welfare state on more rational and comprehensible lines.<sup>113</sup> In opposition, the idea of concentrating resources on those in need allowed the Conservatives to exploit CPAG's campaign against Labour whilst also delivering savings which could be used for tax cuts. When this selectivity agenda ran up against the problem of the poverty trap, Cockfield's scheme provided Barber and Joseph with an alternative solution to family poverty which blurred the line between means-tested and universal benefits. Once implemented, the scheme would simplify the tax system, reduce bureaucracy, and make work pay – fulfilling a raft of traditional Conservative aims whilst burnishing the government's 'One Nation' credentials.

Although it only emerged mid-way through the Parliament, the Tax Credit Scheme slotted neatly into Heath's broader modernizing programme. Like other characteristically Heathite initiatives – the Industrial Relations Act 1971, the Housing Finance Act 1972, Joseph's NHS restructuring, and Peter Walker's local government reforms – it represented a radical attempt to overhaul traditional institutions and establish a framework for future progress. As Peter Hennessy has argued, 'no Prime Minister since Lloyd George... had made such a deliberate and determined effort to remodel the whole machinery of state'.<sup>114</sup> In common with Heath's other institutional reforms, however, the scheme's technocratic ambition was ultimately a source of weakness because its cost, its complexity, and the constraints it imposed on future policy were wholly disproportionate to the problems it was likely to solve. By 1973, the government had boxed itself in to introducing a highly universalist system of child credits, paid in cash to mothers, which sat uncomfortably with the Conservatives' commitment to promoting individual responsibility. The collapse of the Barber boom made the fiscal implications even more alarming, and prompted a crisis of confidence in the Treasury and the British state more generally.<sup>115</sup> It is hardly surprising that the incoming Labour government put the scheme out of its misery.

The abandonment of the Tax Credit Scheme, then, was understandable enough; but something was also lost in the process. Although the Wilson and Callaghan governments introduced Child Benefit and increased spending on social security, the mid-1970s marked the transition from an era of creativity and innovation in British social policy to an era of piecemeal reforms which cumulatively eroded much of the post-war safety-net. This was partly a result of the post-1973 fiscal crisis, but it also reflected a hardening of public attitudes towards welfare and redistribution – by 1979 half of voters believed that welfare benefits had 'gone too far' – and changes in Conservative ideology and statecraft.<sup>116</sup> Where Heath sought to use technocratic policies to mitigate poverty and legitimate capitalism, Thatcher relied on the more traditional tools of rhetoric and persuasion to justify the outcomes of the market system. The horizons of social policy shrank and the scope for new ideas diminished as concern about poverty was subordinated to the need for tax cuts and a crackdown on welfare abuse. The dramatic increase in inequality during the 1980s, and the

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<sup>113</sup> Stephen Thornton, 'A case of confusion and incoherence: Social security under Wilson, 1964-70', in Glen O'Hara and Helen Parr (eds), *The Wilson Governments 1964-1970 Reconsidered* (Abingdon, 2006), 136-54.

<sup>114</sup> Peter Hennessy, *The Prime Minister: The Office and its Holders since 1945* (London, 2000), 337.

<sup>115</sup> For this crisis of confidence, see Keith Middlemas, *Power, Competition and the State* (3 vols., Basingstoke, 1986-91), III, and Sir Douglas Wass, *Decline to Fall: The Making of British Macro-economic Policy and the 1976 IMF Crisis* (Oxford, 2008).

<sup>116</sup> This calculation is based on the 1979 British Election Study: see Joanna Mack and Stewart Lansley, *Poor Britain* (1985), p. 249.

continuing preoccupation with 'scroungers' and 'shirkers', stand as testimony to the significance of this cultural and political transformation.