Overcoming barriers to tax reform

Ed Balls

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Biographical details

Parliamentary history

2010–2015: Member of Parliament for Morley and Outwood

2005–2010: Member of Parliament for Normanton

Government and Opposition career

2011–2015: Shadow Chancellor of the Exchequer

2010–2011: Shadow Home Secretary

May–Oct 2010: Shadow Secretary of State for Education

2007–2010: Secretary of State for Children, Schools and Families

2006–2007: Economic Secretary to the Treasury

1997–2004: Chief Economic Adviser, HM Treasury

Ed Balls was interviewed by Gemma Tetlow, Joe Marshall and Thomas Pope on 3 September 2019 for the Institute for Government's tax reform project.

Gemma Tetlow (GT): When the New Labour government first came to power, did it have an overall tax strategy?

Ed Balls (EB): Well we'd been out of power for a long time. Labour had thought it would win in 1992 but it had not. I left the *Financial Times* in 1994 to go and work for Gordon Brown, before Tony Blair became the leader. And then John Major went the whole five years – which was unexpected, so the truth was, certainly from a Treasury point of view, that we'd done quite a lot of preparation – mainly because there was a lot of time and because there was a real chance of a change of government. Whether Tony Blair or Gordon Brown ever accepted that, I think they were always very superstitious, but the rest of us got on with it and I spent most of my year before the election in '97 doing preparation and quite a lot of it actually was about tax.

And what were the principles? I guess the principles were, one, we needed to raise some revenue and the windfall tax was probably the most obvious example of that in that period. Second, the difference between Labour and Conservative governments coming into power is that Labour governments tend to believe that government can do good things. I think if you're good at policy making, you have to remember that you can often do bad things as well. So, if you are ignorant about public choice theory and governments making mistakes, you get things wrong. And we made some mistakes. But fundamentally we thought government could do good things. And if you think government can and needs to do good things, then you have to think about what are your levers? And obviously the tax system is potentially a powerful lever. And so, I think, and this is my second point, that we perceived an asymmetry in Treasury economic tax thinking at the time, which is that incentives were asymmetric. That nobody ever believed the tax system could incentivise good behaviour, but everybody really believed that the tax system could incentivise bad behaviour. That explains why Nigel Lawson aligned capital gains tax and the top rate of tax. It wasn't because he didn't think incentives mattered, he thought if you had a difference between those two rates, this would incentivise bad behaviour and tax avoidance. And we thought if you can incentivise bad behaviour, maybe you could also incentivise good behaviour, so long as you're aware of managing the bad incentive side of that.

So when we arrived in the Treasury in May '97, a year's worth of work had been done on the windfall tax, we'd also had a year's worth of work looking at ways in which we could incentivise more long-term corporate investment and, in particular, the second and third stage of growth of small 'growing' businesses. We looked at the dividend tax credit and the incentive to distribute [it created]. We looked at ways in which you could incentivise people to reinvest in businesses with a lower rate of capital gains tax for people rolling over owned assets. We also introduced a tax credit for research and development, again an identified problem with the UK economy.

Second, we also sought to find workable ways to incentivise good outcomes through the tax system, and another area where we'd done a lot of work pre '97 in the same vein was around the environment.

And then I think the third objective was that there were, if you wanted to use a tax system to incentivise good behaviour and you were going to introduce incentives in the tax system in some areas, then the quid pro quo ought to be that, where you could, you would simplify and streamline and get rid of distortions, where they weren't doing good things and might be doing bad things.

And then the fourth thing, which is obvious if you're any government, but especially for us, was that you also had to understand who would win and who would lose, and what the distributional impact would be.

So, when we arrived in '97, I met Terry Burns [Treasury permanent secretary] on the morning of the polling day [and] I gave him a wad of papers we'd done about the windfall tax, a wad around corporate tax reform, capital gains tax and R&D. I don't think I gave him stuff on the energy tax at that point because we were still working on it. Then we had some other things which were ready to go, for example around employment and national insurance reform, which we'd done the work on but waited until we got to the first budget. With each one of them we'd thought about where we were trying to raise money, what we were trying to achieve in terms of the behaviour, and who would win and who would lose. Andrew Dilnot gave us the very clunky version of the IFS [Institute for Fiscal Studies] tax benefit model in '95 and we paid a poor researcher who was on secondment from one of the big accountancy firms to sit in an office at LSE [London School of Economics] for a whole year cranking the tax benefit model. And so we spent a long time before that year in '97 trying to learn how the personal tax system worked from a distribution point of view. Another policy with a behavioural aspect was what became working families tax credit. But at the time we would have thought about it as the earned income tax credit. So, there were a range of different things.

GT: Do you think it was important for your ability to get those things done that you had such well worked up plans already done in opposition before you came into power?

EB: I think it depends on the policy's objectives. In the case of the windfall tax, absolutely. Because Gordon Brown had made the commitment to the windfall tax in 1993, and the truth is there were lots of other people very senior in the Labour Party who'd have ditched it if they could have done. But because by '95 the New Deal jobs programme had become a central part of what we were offering in the election, it guaranteed jobs and training for young people~~.~~ Because that had become such a central part of our jobs and modernising message, we had to pay for it [and] the nature of tax in politics at the time meant it was impossible to propose anything where you couldn't show how you pay for it. It's kind of different now because we live in a different era. So, we couldn't talk about the jobs programme unless we had an extra means of raising the revenue. In the 1997 election shadow chief secretary Andrew Smith spent three days being hounded because we'd spent money which was going to come from the privatisation of air traffic control, NATS – which was a couple of hundred million – and there was this 'black hole' in Labour's plans. And when you think now how money is thrown around left, right and centre, but back then it was a big deal. For us the windfall tax had to be credible through the election campaign, which meant the work had to be done.

The second thing which was as important as the tax policy making was the legality of the change. At the time, British Telecom were making a big fuss, and all the legal advice, basically said that if the modus of the tax was discriminatory, you were finished. So, we had Arthur Andersen and a QC do a load of work on the tax. We drafted the legislation and we had done all the legal work, so when we arrived at the Treasury our pile of windfall tax papers was very thick, but I think that was essential because we were so worried about it unravelling and we wanted to move quickly – and we wanted it to be the first budget – we didn't want the Treasury to think we didn't know what we were doing. But we also had to know what we were doing. Whereas in the case of the corporate tax reforms, the signal we gave to the Revenue was that these guys were serious. We were all learning. So in a way, going through a year's worth of policy making practice was I think quite good for all of us. That's how we saw it at the time. Then there were other areas, such as on the environment side, where it was a whole year before we went public with anything. And on national insurance we commissioned a review immediately. I think aside from the windfall tax more generally, there was a desire to have a rich start.

GT: Did having that four-point strategy help frame the policies that came after that? And did it kind of keep things focused in one direction?

EB: When you asked me what our strategy was, I ex-post rationalised what our strategy was, I think that was de facto the strategy we implemented, but did we ever write down our four-point plan? I'm not sure.

GT: What were the barriers that you encountered in trying to make big tax changes and were there things that you managed to do to make progress?

EB: Well I think you start with an internal inertia and kind of caution about change. The Revenue and Customs and Excise (because they were separate at the time) have a small number of people who make policy and a very large number of people who implement the system. I'm not sure change is necessarily always what the implementers want. Because it's quite disruptive. And so internally there was always a hearts and minds argument to win about why the reform was important. But also I think if you go to do something complicated, where there are going to be winners and losers, one of the things which is really important is to win the argument about why the objective is important, why the tax system is relevant to meeting that objective, why the tax system at the moment is not as good as it could be, and the kind of principles which could guide our approach in thinking about using the tax system to meet that objective.

When we arrived with the windfall tax or the corporate tax reforms, we had done a version of that. But what we regularly used was outsiders who would help us to do reviews where the purpose was as much about establishing the case for change as it was what the detail of the change would be. And I think one of the mistakes you could make in tax policy making is just assuming that the case for change is clear and therefore you just jump straight into the measures. What Martin Taylor did for us on national insurance was spend maybe six months doing a report about how we could change the national insurance system to take away barriers to part-time employment creation and make it easier for people to increase their hours and their earnings without hurdles along the way. And although he ended up making tax proposals, much of what he did was establishing why there was a problem and the case for change. If we'd said to the CBI 'we're going to make Martin Taylor's proposals cold', I think they would have reacted very badly. Whereas because we said 'here's a really important objective which we believe you share, we're getting this guy who is external from us to do some work for us, can he engage with you?' and you take them on a policy making discussion and journey…

JM: Who were these external reviews primarily aimed at?

EB: I mean, realistically, all the messages the public receive are mediated. And so you don't realistically expect members of the public to read the Martin Taylor Review. But the audiences were definitely internal, external affected stakeholders and then the wider, media policy discussion. And they're all, in their different ways, important. We used these reviews much more widely than in tax policy making, but we did use them in tax policy making and there are certain things which are important about them. I always felt that they generally worked best when they were done by one person. Because it should be their view. It wasn't the government's view or the collective view, it was their view, which means that they owned it, but also it meant that they were the seller and that the government wasn't fully committed to their view from the start.

Second, the purpose of the review had to be clear from the start. But I would always advise the reviewers that they should wait a few weeks before they go out with their call for evidence because actually the first thing they have to do is absorb what the issues are and make sure the questions they're asking are really the right questions. People got into trouble doing these reviews when they go out and do an interview in the first 24 hours and then spend the whole of the next year trying to row back from what they said in the first 24 hours.

The third thing was it was important to have an interim report which wasn't about policy, which was about purpose and principles. Because that is the point when you really start to win the argument. And if you get a good reception from the stakeholders to your interim review, they're then with you on the how; whereas if you haven't won that argument, they're never going to come with you on the how. The interim review's really important. We always tried through iteration to get to the point where we were going to be able to accept the reviewer's conclusions. That isn't to say that we had to or that they had to propose things we'd accept, but actually, reviewers tend to want to propose the implementable. And that's actually kind of a good discussion internally because it means that the machine becomes part of the how, and the other thing which I always thought was really important (and I actually think the best reviews did this), was that you should make it a condition from the start that you will come back after 18 months and do a progress report on whether the review had been implemented. And that was one thing that the machine never wanted was the follow up, the 'had they done it?' question. Whereas if you're actually trying to change things, that's really important. I mean a good example of this not happening was the Banking Commission chaired by John Vickers, he didn't do a follow-up review. But I kept telling him he should do this. You can see from that that the audience is the stakeholder, the media and the civil service.

GT: Several people have mentioned to us the importance of having political drive from the chancellor and senior ministers on these policies, is there a similar need to get chancellors to believe in a vision for tax reform and to come on board with it before then pushing forward? To what extent did you as an adviser play this role?

EB: In terms of tax policy making, you have to win the argument for why. You have to understand the distribution. It's really hard to do it when you're also raising money. It's always easier to have some 'lubrication'. And you always have to remember that the losers will shout more loudly than the winners, and therefore the organisation, or the galvanisation, of the external world is really important. To give you an example of this, we came into government thinking about what we were going to do about CO2 reductions and climate change. And to be honest that was partly revenue motivated at the time. I think, if you remember, John Major had introduced a fuel duty escalator which was ostensibly about the environment, but frankly it was about revenue… and we increased it because we needed the money as well. I think the debate about the environmental taxation has evolved from the mid-90s to today.

Today it becomes much more about policy and objectives, whereas 25 years ago it was at least as much about money – but it was about both. And we initiated a discussion about using the tax system to reduce carbon emissions and we'd have regular internal discussions about how the ideal thing would be to get to a form of carbon trading, but this was a long way away from happening. In the meantime, we thought, what are we going to do? Could we raise some money and in the '98 budget? We asked Sir Colin Marshall, who at the time was president of the CBI, to review a possible energy tax. And at the time, the permanent secretary at the environment department nabbed me the day after the budget and gave me a really hard time, saying "you snatched defeat from the jaws of victory, we could have legislated for [an energy tax] and you guys were cowards. And rather doing it in the budget, you set up this review with the CBI, now it will never happen". But we felt that this was a long-term reform and it was clearly quite controversial, it was the Labour government doing it and therefore you just have to take your time. And Adair Turner was the director of the CBI and he understood the wider arguments. Colin Marshall spent a year doing his interim report and his final report, and then I think we ended up legislating for his energy tax in the '99 Finance Bill, which had never happened in the UK before. Now it was not perfect, and it wasn't the best piece of tax policy ever, but it was a big step forward and I think you always have to see these things as an evolution. You never get to perfection in one leap and sometimes you have to go in stages. People don't just judge success on the basis of the outcome, but also the nature of the journey that you are on.

We had a big problem which was that the large energy users were very, very upset about this and Colin Marshall proposed that they would pay a much lower level of the energy tax in return for voluntary negotiation agreements for carbon reduction. And by that point we'd moved away from our revenue-raising motivation into our behavioural outcome motivation. The process of this discussion then in Parliament goes on for one or two years, and it's really hard. The big energy users make a lot of noise and there's quite a lot of MPs who are quite influenced by this and, to be fair to Tony Blair and Gordon Brown, they were clear this was a good thing to do and so if Gordon Brown as chancellor had not been committed to doing this, it would absolutely have died in the first six months. So, the answer to your question, none of these things are easy and it's always hard, there's always lots of noise. People have to believe that there's a reason for doing it which is important.

However, we were quite tested by that period because, as I said, the next generation or the generation after who benefit from environmental taxes isn't really in a position to give you a positive campaign. The losers were quite loud. We had these regular meetings with the environment NGOs [non-governmental organisations], who were just a nightmare because the only thing that would ever unite them was being disappointed that we hadn't gone as far as they would have liked. And me and other advisers, Ed Miliband and Michael Jacobs, would meet them every three months and say "we are legislating for this tax it's really new, it's the precursor to big things to come later, nobody's done this before. You should be really, really championing this. Of course, it's not as good as you'd like, but say to us it's a real step forward, we want more but it's a real step forward because we need that energy" and they found it really, really hard. There were definitely times in that period where the chancellor and the prime minister would say "why are we doing this?", so it's really important to keep senior politicians on board.

GT: Do you think with benefit of hindsight you could have handled that any differently?

EB: There are lots of things which we could have handled differently. I actually think on the energy tax we did a pretty good job. I mean you're always trading the ideal against what you can put in legislation and what is politically deliverable. Sometimes you have to put something on the statute book, which is good, but not as good as it can be. Sometimes the tax reform can be the whole package in the budget. But I think in general when you are doing things which are hard and new, it takes a long time and there's a lot of iterations. George Osborne tried in the 2016 budget to really curtail tax credits. And was rebuffed by an opposition which included Nigel Lawson in the Lords. And that was a reform which we first began to talk about in the 1997 budget, we just went through this very long iteration and evolution, and it's great that it's still there, I mean it's not as good as I would have liked, but it's pretty good. But it's been through lots and lots of iterations along the way and I think that's probably the way in which these kind of things work. You can't do a review, draw up your blueprint and then consult on whether we're going to deliver the blueprint, because it's not how it works. In the end, people will find reasons against it. Part of the reason why, for me, social care reform has just been so hard to deliver is because the people come up with big bang solutions and then recoil from them. Whereas politically you just have to go step by step, and it's okay to start with something less ambitious because that's how you win the argument for the next stage.

GT: And you've sort of talked mostly in your examples about ones where major losers were companies rather than groups of individuals, were there any other strategies that were successful in winning the case with the losers?

EB: In the first two budgets, '97 and '98, we abolished Married Couple's Allowance and Mortgage Tax Relief. There was some revenue raised, but we were also simplifying at a time when in other areas we were introducing some complexity. And, if you look at those budgets, they were done at a time when fiscally and macro-economically it was okay to have a small net loosening. We thought hard about the way in which you could not only explain the individual tax change where there would be a loser, but how that would fit into a wider package of other tax changes which are happening at the same time. So that would be one example.

GT: Were there particular things that you packaged together?

EB: My memory is we introduced a 10p tax rate and then we cut the basic rate [of income tax] in 2001. There were other tax changes which were happening at the same time. There were changes that were quite big revenue raisers and others that reduced revenue, so the structural change was bigger than you would see from the net amount of revenue raised. Obviously then in 2002 we introduced the national insurance tax rise for the National Health Service – I mean you could have said everybody was a loser there. Everybody was also a winner.

The actual tax part of that reform was introduced in the 2002 budget at the end of a three-year process about winning the argument about why the tax changes were necessary. The Wanless Review (and the interim Wanless report in the autumn of 2001) were all about establishing why the tax change was needed. Now that one doesn't really pass your test because that's less of a tax reform and more of a piece of revenue raising, but it's a good example of the amount of time you have to spend to win the argument.

With tax credits I guess there weren't really losers, there weren't really intended losers. That's the best way to put it. Working tax credits are actually a really interesting example as well because we had a very clear intellectual starting point which was, first we were introducing a minimum wage, but the minimum wage could not do the work on its own to tackle in-work poverty. And therefore, you had to find a way to make work pay other than the minimum wage. Secondly, that while there was support for this, the CBI were advocates of family credit which had been introduced by Norman Fowler, but the problem was the family credit was a benefit and that was politically harder. In the US (admittedly in a very different tax system), the earned income tax credit was a way in which the tax system was rewarding work. Politically, the tax system rewarding work was easier for us to handle. The question, therefore, was could you find a way of integrating tax and benefit to make work pay through the tax and benefit systems working together. And that was the starting point. And we ended up with tax credits. Two things which came along which I don't think we were anticipating at the start, both of them are about the nature of households.

The first was that the introduction of independent taxation by Nigel Lawson at the end of the 1980s – absolutely an important principled reform – was also one of the most regressive tax reforms ever seen, in the extent to which that handed very large amounts of money to the top two deciles of the population. Once you have independent taxation, using the tax system for a household assessment just becomes incredibly difficult. Related to that, you have the issue of who the money was to be paid to.

But the second thing which, interestingly, I don't think either we or the Revenue understood, was the nature of instability of income and family patterns in the client group. And it was actually a really important lesson in tax policy, that it's all very well talking to the policy makers in the Revenue, but actually the complexity happens in the implementation, and the implementers are just a massive resource that you have to draw upon. Tax policy making is not a piece of analysis or theory or economics, it's also about practicalities and deliverability.

There's a very important principle we have which is that ministers don't know about the individual tax affairs of individual companies or individuals, great. However, the people who deal with individual companies and individuals have an understanding about how the tax system works in practice, which you've got to be really foolish to ignore. The problem was the Revenue and Customs had great expertise in some areas, around the corporate behaviour and avoidance, or tobacco and forestalling at the borders. But the area where neither they nor the guys who moved over to the Revenue from DSS

[Department for Social Security], properly understood the nature of, was the patterns of household incomes. And I think to understand that you probably would have needed to be in an individual DSS benefit office and that was too far away. I don't think they had that kind of reach.

As part of the introduction of working families tax credit in the early 2000s, we had to decide how much you would allow people's income to vary from their assessment before you would claw back. And we, I mean very much on the basis of advice that is kind of finger in the air, chose this number which we were reassured by the Revenue made sense, which was a few thousand pounds. And then what transpired for the next two or three years is that for the kind of household you're talking about, the year-to-year variation of their incomes was absolutely massive. I mean factors of three or four times our limits. We just had this unanticipated complexity. So we ended up with this huge controversy through the early 2000s of people suddenly getting demands from the tax credit office to repay thousands and thousands of pounds on the basis that their income had risen so drastically compared to the previous year, or the guy they lived with had moved out or whatever. And in the end, we just enormously widened the year-to-year flex. At the time, we were worried that what we were proposing would be seen by the *Daily Mail* as this massive giveaway and that wasn't a problem at all, the problem was the claw back of money from recipients. And so, I think everybody learned that if you are a tax policy expert, whether you are at a university or the Revenue or the Treasury, or even at that time at the IFS, that it was so easy to think about the representative household and how they'd be affected, or to think about where people sit on the income distribution, rather than the dynamic nature of household income instability, which took everyone by surprise. And I think as a result we learned that you have to anticipate far, far more practical complexity.

GT: Did that learning lead to any changes in the way that you then made policy in future? Or who you spoke to when you were developing policy?

EB: Well I mean I'm not the expert on this and somebody like Tony Ornhial was the main person at Revenue at the time. Or Ed Miliband who did this a lot more than me and looked into the detail. There were certain things that, once you learn them, the institution never forgets. It's a bit like PFI and IT, once you've dealt with an attempt to use private sector contracting process to contract IT systems in the public sector, you never do it again. And I think similarly it wasn't incompetence, it was just something that took everybody by surprise and once you've seen it, you never forget it. I'm sure it had an effect. Two other things I'll just say in terms of our experience, just so we cover them all. I think even though we got that wrong in general from the beginning, we were always worrying about who the winners and losers were and understanding about the distribution and the optics of that and how it will play out. And obviously the one time when the chancellor/Treasury decided to ignore all that and take a punt was with the 10p tax policy. We spent huge amounts of time trying to see how you could reform housing benefit in a sensible way and the reality was that unless you've got enormous amounts of money, just dealing with the distributional consequences is so hard because of legacy policies. In terms of the behavioural stuff, I actually think that what we did… dealing with that asymmetry point and being aware of public choice, I think that what we did around capital gains tax reform and trying to ring fence the reduction in the capital gains tax rate for business assets to 10p, actually worked well. It's understandable why, when suddenly you're short of revenue, people look at a better way to raise it. But I think that is an example of how we did a pretty good job, it wasn't perfect.

The time that didn't work was when Gordon decided he wanted to have 10p income tax rate and then the zero-start rate of tax for small businesses in order to encourage incorporation, which just led to loads and loads of avoidance. There were often times when the experts, both on the political side, Chris Wales was our tax person, and in the Revenue, were saying "look it's all very well but we're pushing this to the limits", so you've got to listen to the warnings. There were warnings about the introduction of a lower starting rate of corporation tax reform [but] every now and then for chancellors, the politics can feel like it's more important. In general, when the politics feels like it's presentationally more important than your advice on the substance, in general you should listen to the people who know about the substance.

GT: In your experience, are there other things that make someone in Chris Wales' position more effective in getting across the concerns that they might have about policies that appear politically attractive but might have downsides?

EB: I don't think that's particular to people who are political appointments or advisers. I think it's also as true of people who are in those key jobs in the civil service machine, as I always call it, in that you have to be credible with both audiences. You have to be credible with your minister, and you have to be credible with the people who are actually going to implement the policy and you always, I think, have to be looking for the problems and one of the great ironies, the omnishambles budget is that… I was in meetings 10 years ago going through all of those policy proposals and they got rejected because if you have people like Chris Wales, or senior civil servants who were for months going through your potential score card, wanting to know what's going on, how does it work, what does it mean, have we spoken to people who deal with this, what are the downsides? Who's going to win, who's going to lose? If you do all that work and are always thinking about the disruption and the complexity of the cost versus the positive, the truth is there has to be a lot of money or a really, really big payoff to risk complexity and a bad distribution [of losers]. The things which are controversial don't raise you much money and have loads of loud losers – if you're any good at tax policy you just ditch them. But having people who are credible in both the political and technical worlds is really important. You can say to the minster I know we are trying to achieve this, and I understand that but actually this is the problem. But at the same time, I can have this same kind of conversation with the guys who know the detail of this in some office in Swansea.

GT: And when you say have credibility, is it that they have the experience and the expertise to be challenged by both of those groups?

EB: I suppose so, yes. Chris did a year with me on secondment from Andersen, '96/'97, and was then at the Treasury for a long time – 10 years, maybe longer. From the beginning, he understood what we were trying to achieve. Every now and then he would look at us like we were mad. But he could have a proper conversation with the people in the bowels of the Revenue. You could ask him "is this actually going to work?", and he could give you a view based upon the detail and how that the tax system actually operates. And I think that is just something which comes from working on tax for a very long time. An institution like the Treasury needs, aside from someone like Chris, people who work on policy. Actually the nature of the civil service is that you have people move through jobs and so not everybody who is a grade seven or a grade six needs to be steeped in that policy area for the last 20 years, but you need some people who are really steeped in that policy area who are the kind of people who can speak to ministers. Because we always found that getting those kinds of people in front of ministers and explain to them why in practice it was hard was important.

Joe Marshall: Was this part of a reason for moving more tax policy over to the Treasury following the O'Donnell Review? Was it about bringing in those people to Treasury who could do some of this thinking and explaining?

EB: You'd have to ask Gus really, because by that point I was more on the outside, but one of the things Gus was trying to do was to avoid sort of communication gulfs and make sure that where there was expertise, it was available to all rather than just some. And it was certainly the case in the early period [of the New Labour government] sometimes – the deep expertise on tax policy making was quite a long way away from the Treasury. I think it always felt that having multiple centres of policy expertise back then was quite frustrating. And that could be geographic, it can also be cultural. I think probably the way in which communication has changed ought to bring those kinds of things more closely together, because these days they wouldn't have to get on a train, they just go on Skype, but that wasn't available to us then. In fact, when we arrived at the Treasury, none of us had used an email!

Thomas Pope: Were there any particular policies that you wanted to implement but were unable to either build the case or convince the chancellor on the tax side?

EB: Well we always wanted to find a way to integrate the household with tax support, including working families tax credit. And in the end that was just too difficult because the nature of the household assessment for tax credits was just too invasive. And it always just felt very frustrating because people were, consistent with independent taxation, sharing capital gains, and inheritance tax allowances. We had this continual rolling argument with the OECD [Organisation for Economic Co-operation and Development] about whether tax credits were a tax or a benefit. Even though they were paid through the pay packet, and even though they were being administered by the

Revenue, because the UK tax system is on an individual basis, and tax credits were based on a household assessment, therefore the OECD view was that they must be a benefit. And you could see why from the government's point of view, that was a problem. So that was a continuing issue. We spent a long time trying to think about whether you could roll housing into that. And since 2010, all the reasons why that's hard have been re-discovered. But that was something we looked at various times and pulled away from.

Another area where we spent a lot of time looking to try and find a more sensible tax solution was around local government finance and replacing the council tax, which was a cobbled together piece of tax policy in 1989 to replace the poll tax, it's a bit like the Barnett Formula. Sometimes things are done to solve an immediate problem and however second best they are, every time you try and find a solution it's just so hard – unless you're going to make very, very big decisions. I've lost very many hours of my life looking at alternatives to the Barnett Formula and some kind of needs-based assessment of public spending allocation. And devolution has increasingly made that very hard. But even before that, just finding a way to do it is difficult. And similarly, with council tax, unless you want local government re-organisation and unless you are willing to go to taxation on proper, viable, big enough areas, the politics of moving away from a housing-based tax to a local income tax is really, really hard. It's obviously better, but it's just really, really hard.

JM: Is that one of the reasons you more recently looked at things like mansion tax, additional smaller taxes rather than revisiting council tax? Because it is so difficult to reform?

EB: Yes. There was a period where council tax was incredibly controversial in the mid-2000s and then the heat went out of that… All our theoretical analysis always told us that housing was under taxed. Finding a way to do that simply on transactions was very lumpy and friction-inducing, and sometimes a bit discriminatory. But finding a way to have a capital tax is very difficult because of the particular nature of households. The council tax deals with that, but in a way which is quite perverse at times. And the mansion tax was essentially a way of trying to introduce a new council tax band without calling it council tax. Without requiring local authorities to take all the political heat for it. By absorbing it into the centre. And trying to do it with sufficient safeguards that you wouldn't hit people who are vulnerable. It's a very difficult piece of policy making.

GT: Do you think the objection to that mainly came from the low income, high value property group? Or was it partly skewed by the fact that most high value properties are in London?

EB: The difficulty you always have is that you always have to think about what your objective is and how people will see it, and then who thinks they're going to be affected? Take the 1992 shadow budget, John Smith's shadow budget, the amount of people who were actually going to lose from that was a small percentage. But the percentage of people who thought they were going to lose was very large. It ended up becoming a version of 'tax the rich'. And people think 'oh my god maybe that means me'. And so, which goes back to my broader point, which is about winning the case for the purpose is really important, because if not, people just assume that the purpose must be something else. And I think a similar thing happened with the mansion tax. The number of people who are actually going to pay it was a tiny amount. The number of people who were in the particular example you're talking about of the high value, low income was a very small number. And we had a way to address the problem, for them to capitalise it and never pay it anyway. The trouble is that, I think, a much, much larger group of people assumed it must be them. And what we were really saying, we were saying we were going to tax people's houses and therefore that must be mine. If you haven't won the compelling argument for why, then it's hard. Generally, everybody making a small contribution for our big goals is easier than a small amount of people paying a large amount, if a rather large number of people think maybe that's going to include them.

TP: Do you think there are very different challenges for Labour and Conservative politicians? Very different barriers there?

EB: At the margin yes, but fundamentally no. George Osborne had his omnishambles budget and his tax credits debacle, and Gordon Brown had his 10p income tax episode. So, in their way they're quite similar, which is that, in the end, the losers think it's unfair and everyone agrees with them. I'm not sure there is a big difference. If there was a Labour government today, on the day when the pound falls to its lowest level since 1985 against the dollar, there would be a bigger outcry than there is for the Conservative government. So, there are times when absolutely the optics of policy are very different for the different parties. But I think when it comes to winners and losers of tax policy, I'm not sure there is a difference. I think in the end those things are much more similar. In both cases you have to have an eye on the distribution, win the case for the purpose and it has to feel fair. It has to work.

TP: And is your general impression that the barriers and winners and losers problems have got worse in the last say 20 years?

EB: Well, it's 15 years ago that we raised national insurance for the health service. I don't think before that any developed country government had raised a tax on that scale, paid for by so many people for a positive purpose. I don't think that that is a one-off, I think you could do that again, but you just have to spend a long time winning the argument for the purpose. Governments raise taxes at times of crisis, so George Osborne's VAT rise at the beginning of the last decade for example. Sometimes you have to raise tax in a way with tough distributional impact when things are going wrong. But I think doing things when you don't have to do them, and when you're trying to make a positive argument for them, is harder. And that's the kind of thing which was done by people who believe government can do some good things and want to win the argument. But I suppose, in terms of my learning, I would say to you that really understanding how things work in practice through the experts within the departments, and really understanding the distribution, and really understanding the dynamic distribution, those things are all very important. But the most important thing is winning the argument for why in a very big way before you get involved in the detail of the tax policy making. Because if people don't feel that it's compelling, then the losers and the counter arguments will always have a bigger sway. If you've got money available, you could always compensate and lubricate, but fundamentally if you haven't won the argument for the purpose then it's very hard to do it with tax reform. That is a very political economy way to say it, and I don't think that would be in the Mirrlees report.

To make good policy you have to open up the space and you have to move into it. If you haven't opened up the space, you can't move in, and there's only so much government can do to open up that space. The space is at least as much to do with the representative organisations, the stakeholders, the potential winners, the bigger purpose and if you spend enough time thinking about how you can win the argument and open the space, then you've got a chance of moving in. If you move in in the wrong way and screw it up, then it's really bad. If you haven't opened up the space, you can have great policy and it's just not implementable. For instance, even though we had the CBI on side for our climate change tax reforms between 2001 and 2005, the environmental NGOs made our life very difficult. On the other hand, when we were working with Jubilee 2000 and Make Poverty History on global debt relief, they would surround the Treasury every year with a demonstration and stop everybody going in and out with bells and whistles and horns and pushchairs. And every year about three weeks before the international meetings, we'd ring them up and say "we do hope you're going to do your demonstration" because actually it's really helpful to us. We're then going to ring up the German Finance Ministry and the American Treasury and say "oh god we're surrounded again, you're going to have to do something". We were having this meeting with the NGOs, Make Poverty History saying "it's all very well these postcards you keep sending them to Downing Street and that's fine, we love them, but send them to the Japanese because they're the ones who need to be deluged". That's what I mean by using the space. It's intellectual, it's about the purpose, but it's also about the campaign. And we try to do the same thing around UK child poverty and tax credits, it was always hard.

GT: If you were giving advice to your successors, perhaps particularly in the context of minority governments, what advice would you give them on how they could open up that space for tax reform?

EB: I would say that I wouldn't want to do anything in a budget which I've not been working on for at least a year. I'd want to really know that the senior guys I was working with at the Treasury and the Revenue were really looking for all the problems and the flaws and how it actually works, and that we really knew what we were letting ourselves in for. So I'd never want to be scrabbling around in the last month in a scorecard meeting looking for some revenue to fill in a gap. And what I would never want to do is ever present something as structural reform which was actually a last-minute stopgap to bring in some revenue. I would always want to be out early with some kind of process to win the argument for why. And to involve external people, or organisations, as much as I could at an early stage in doing that. As I said, I think the perfect is often the enemy of the good and that you have to move in stages, you can't just jump to your big solution all in one go because that's just very hard to achieve. You have to ask, is it worth a candle? It's a very tax policy question, is it worth a candle? Loads and loads of grief to raise a few hundred million from the pasty tax was really, really stupid, but something else which starts you off on a direction which allows you to, in the end, get to a big prize is worthwhile. I'm not using this as a good example, but if you think about the insurance premium tax, when it was first introduced it was a small amount of money but, and the same thing with air passenger duty, these things can, over time, become much more important. But on the other hand, there are also things which look like they are short-term stopgaps if you get them in, can then become a real bugbear, council tax being a really good example of that. You have to know what your dynamic path is and be sure that's a path you want to set off down. And never ignore the distribution.

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