Overcoming barriers to tax reform

Lord Burns

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Biographical details

Parliamentary history

1998–present: Crossbench Peer

2002–2003, 2016–present: Member of the House of Lords Economic Affairs Committee

Civil service career

1976–1979: Member of the HM Treasury Academic Panel

1980–1991: Chief Economic Adviser to the Treasury and Head of the Government Economic Service

1991–1998: Permanent Secretary, HM Treasury

Lord Terry Burns was interviewed by Joe Marshall and Thomas Pope on 10 July 2019 for the Institute for Government's tax reform project.

Joe Marshall (JM): On entering the senior civil service, what experience did you have of the tax system and tax reform, and how did your role in that evolve over time?

Terry Burns (TB): Well, at first, not very much because I had a rather strange career. I worked at the London Business School from 1965 to the end of 1979, basically building models of the British economy and using them for forecasting and policy purposes. I also did quite a lot of teaching in the '70s. My main knowledge of the tax system, apart from what I experienced myself, was in model building, which was in trying to build models of the tax system amongst everything else that we were doing. And that was basically it. In January 1980 I started as chief economic adviser, which I did until May '91, and then I was Treasury permanent secretary until summer of '98.

We were trying to model the tax system for some time, including personal tax, corporation tax – which was probably the most complicated of all – the national insurance system and indirect taxes. It was quite a lot of work. I was running a forecasting group, and we did quite a lot of work on trying to model it to be able to fit the effective policy changes into it as well. So it was at that relatively high level.

All the time I was in the Treasury, from January 1980 through until when I left (in 1998), I attended all of the budget meetings, and indeed I used to write about the macroeconomic background for the budget. So, my involvement in taxes, particularly in the early stages, was more from a macro point of view than from a technical tax aspect – although that included, of course, the balance of direct and indirect taxes and between taxes on companies as opposed to taxes on individuals.

Budgets, of course, have long lists of tax measures, many of which are often to do with cleaning up the tax system in one way for another: trying to plug holes and reducing avoidance opportunities, changes where certain aspects in the system weren't working very effectively, or were working in a way they didn't intend it to. By and large, I didn't have very much to do with those. On any budget scorecard, we used to have a very large number of items which were very small in terms of total revenue effect, but which mattered to various groups. And indeed, it is the case recently, often budgets consist of little but these things. You end up with a long list of changes with very small revenue effects.

JM: In your time in the Treasury, did you notice a change in the kinds of tax measures that were included in budgets?

TB: Geoffrey Howe was very interested in taxes, and Nigel Lawson was financial secretary in the first part of the period. I think Geoffrey had been involved in tax in opposition and he was interested in the tax system and the idea that it was very complicated and needed simplifying. In Nigel's time, what evolved even more strongly was the idea of trying to widen the tax base and to reduce marginal rates. And of course, all of this was against a background of a Conservative government that had put a flag in the ground to reduce personal tax rates, so they weren't averse to widening the personal tax base. But they were, by and large, averse to increases in the actual rates of tax on people. After the recession of 1991/92, there was quite a big hole in public finances, and attention somewhat moved to seeking to fix that hole. Although I think the issues of broadening the tax base and trying to avoid increases in income tax rates remained a pretty firm objective.

One of the things that Geoffrey Howe and Nigel Lawson became quite proud of was the various taxes they had abolished. That trend was somewhat reversed during the '90s as we started to invent new taxes to try to widen the base. Things like air passenger duty tax and insurance premium tax. And when it came to Ken Clarke, I would say it was much the same, although my memory is that Ken was possibly less clear in his own mind about the widening of the tax base. But he still pursued it.

With the New Labour government, the attention shifted somewhat toward tax credits. So, that more or less brought me to the time that I left, which was in mid-'98. Certainly, during the '90s, and to a degree during the '80s too, we did look quite closely at some things like merging Inland Revenue and Customs and Excise, and it was decided not to do it. And, similarly, we looked at the integration of income tax and national insurance contributions, but again that never survived the budget scrutiny process.

JM: Why didn't those reforms to personal taxation happen?

TB: Well, it's the winners and losers problem: you end up with too many losers. And income tax and national insurance are so far apart in terms of their detail. Even today people are talking about trying to align them more closely, but when you go through the painstaking process of looking at it in detail and looking at who gains and loses, and consider the various anomalies that are built into the national insurance system (like the difference between self-employed and employed, the issue of the upper earnings limit, what happens to people post-retirement age), it all starts to look very difficult.

Merging them was considered on a fairly regular basis, as, of course, was the whole question of how far you could widen the VAT base. At each election, politicians went through the process of trying to avoid making pledges about not widening the VAT base, and were constantly challenged during the course of election and always ended up having to say that they wouldn't.

Thomas Pope (TP): Who proposed widening the VAT base and combining national insurance and income tax? Was the impetus political or from the Treasury or Inland Revenue?

TB: Once you have an agenda of trying to widen the tax base and keep marginal rates down, you basically end up looking at all of these things. It followed from the tax strategy that the government had set out for itself. We had a tax group in the Treasury.

Most of the proposals the Inland Revenue would bring forward would be more to do with tidying up the tax system and pointing out issues where there were problems and anomalies with it. Issues to do with whether you should be getting into widening the VAT base – those sorts of initiatives – would come jointly from ministers and the Treasury tax team, and then they would go to the Revenue team for examination and for them to spell out the full implications of it all. The Inland Revenue had the detailed modelling capacity as far as the impact of individual tax changes was concerned.

TP: You said that you weren't that involved in the minutiae of the tax policy development, so who were the key players?

TB: First of all, it was a job that was tended to be delegated by the chancellor to junior ministers, so the financial secretary mainly would be given the job of scrutinising all of those things that the Revenue brought forward. We had a budget starters list, and basically quite a lot of those would be brought forward by the Revenue, and they would typically be dealt with by the financial secretary, who would go through them. And gradually this list would become shorter and shorter as you got nearer to budget day, and as ideas failed to pass either economic or political scrutiny.

TP: Who else was involved in that scrutiny process?

TB: We had a group, if I remember it was called FP, which had a tax team in it, and various people over a period of time. Indeed, Jill Rutter (of the Institute for Government) was in that team for a period when Robert Culpin was heading it up. And so, they were the people who provided the Treasury input and through whom proposals would be steered and indeed who then ran the tax side of things.

JM: What are your reflections on the division of responsibility between Revenue departments and Treasury? You mentioned how there were discussions about merging the departments, and obviously later there was the O'Donnell review, which led to the departments being brought together and tax policy making moving to the Treasury.

TB: Yes, but the O'Donnell review was after my time. I would say, in general terms, I was slightly surprised that the O'Donnell review reached that conclusion. I thought the previous system worked extremely well. We had a policy team in the Treasury but the main tax skills, and indeed some of the big hitters of the Revenue, were involved but on a slightly arm's length basis. They had the people working for them who were the experts in how individual taxes were working and whether there were collection problems with any of them. There was a degree of separation between the operational side and the Treasury, which was quite effective because the operational side, as I say, had some quite big hitters in it who really understood both politics and the economics and the operations. And I was slightly surprised at the idea of moving so much to the Treasury. The previous system worked pretty well.

There was a difference between the Inland Revenue and Customs and Excise, which they were very open about. The traditions of the two departments were very different.

One had grown up basically dealing with relatively well-off people, and it was a question of making sure that they paid the right amount of tax. And Customs was often described as chasing smugglers over hilltops, and they were people who would be knocking on people's doors at 5am. So, there was a different culture, a different ethos. VAT became such a big part of Customs and Excise, and that was much more like a normal tax. On the excise side (fuel duty, tobacco duty, alcohol duty), I don't think the system changed very much in dozens of years.

JM: Prior to the O'Donnell reforms, the Treasury had a relatively small tax team. Do you think the Treasury had enough tax policy making resource and oversight of the revenue departments?

TB: I have tried to think of the things that went wrong. For example, in 1988 Nigel Lawson withdrew double mortgage tax relief for co-homeowners, which became quite important in macro terms. The Revenue said it couldn't be implemented until about the July or August, which was some time after the budget. And we ended up with an extraordinary ramping up of house prices and double mortgages in the six months between the budget announcement and its implementation.

But that wasn't a problem of not having sufficient tax resources. There were some changes which had to be made in '93 about the VAT on domestic fuel and heating which didn't land well in Parliament.

Just as I was leaving, we got into a bit of turmoil about the tax credits, where the government was very intent on taking this policy forward and the Revenue foresaw, correctly as it turns out, a lot of the operational problems involved in trying to merge a system based on annual returns with a system based on weekly circumstances. And that created a certain amount of tension, and was part of the reason why eventually, later on, some changes to tax credits were made. But I can't think of concrete cases where there was anything serious, where "mistakes were made" because of the size of the team. The senior people in the Revenue worked very closely with the team in the Treasury; the fact they were in different places was not really an issue.

When you're raising taxes – trying to extract money from people – it is quite difficult to judge just how strong the political wind is going to be. In the main, when these things go wrong, it is because of the political calculations rather than the technical calculations or the failure to look properly at the income distribution effects of changes. From time to time, certain things just catch the wind and they fly out of hand, but that is basically down to the political process.

JM: Can you give any examples of when the politics made reform difficult?

TB: For most of the reforms that I saw, the Treasury was able to stand its ground. Obviously, there was this case I've just mentioned, of VAT on domestic fuel and then, subsequently, long after I'd gone, there were protests during the [Tony] Blair period to do with fuel duty and the country was almost brought to a standstill. But again, I think that was a political issue rather than a technical issue. After all, nobody could be in much doubt about what happens to the price of fuel when taxes are changed.

I remember on one occasion in the '80s there was an issue when it got into people's minds that maybe VAT would be levied on books and newspapers, and that had to called off before it even started. Widening the VAT base has throughout its history been an issue. And of course, on VAT, there are always these rather tricky borderline issues, although they were mainly before my time. There were issues about cakes and biscuits and whether they were subject to VAT or not.

What makes the budget challenging is that it has this complex combination of political judgment and economic and distributional consequences, as well as technical issues of implementation. When we moved to individual taxation in the 1980s, there were enormous technical problems about implementation. The Revenue would come forward with a number of objections about how things couldn't be done. If you wanted to do something life changing (mortgage interest relief for example), there would be all sorts of issues about how it could be done in terms of the PAYE system, when it could be done, what the delay would be, and typically the further consequence for higher rate tax payers. You could design a system that would apply to people generally, but then required some sort of extra claw back from higher rate taxpayers and this might have to happen a year later. This is what goes on in what I'd describe as the middle stage of budget making, when issues are being firmed up and start to look more realistic, and then they get dug into the detail, and operational problems become things that have to be taken more seriously.

JM: What factors must come together to make a successful reform?

TB: Well, the first thing, and the key to all budgets, I learnt at an early stage, is about packaging. It is about how you play off gainers and losers from one measure with gainers and losers from other measures so that you look at it as a total. And it's crucial. It's very difficult to implement tax reform when you're only dealing with one tax where there are quite clear losers. And very often, of course, there are some distinct losers. It's one of the reasons why I think the recent proposals for the BBC to take over responsibility for whether some over-75s should pay for the licence fee is such a mistake, because you've landed the BBC with an issue where they've only got one tax and there's no way you can package this and offset it by some generosity in some other areas. And so, packaging is the heart of budget making, and it is the thing that really determines whether something is a success or not.

The second question, then, is simply the quantity that you're trying to take in any one shot. In other words, the people who are particularly hard hit. An example, I would now classify as a failure, was the package in the 1990s to legislate for increases in excise duties in real terms forever, going forward (the fuel duty escalator). I don't think it's ever been implemented. This was introduced because, up until then, you had to announce each change in excise duties to allow for inflation. So, the idea behind the reform was to build annual increases into the legislation and therefore you only announce it when you are effectively cutting taxes. There were some ambitious motivations, if I recall, partly because this was the beginning of concerns about the environment and global warming. The idea of putting up fuel duty quite sharply in real terms was regarded as (a) being a revenue raiser, and (b) it worked with the emergence of the environmental concerns.

In contrast, the abolition of mortgage interest relief is, I think, a very good example of something that was done successfully. But it was done gradually, partly because the economic argument had been won, and it was a question then of doing it in a way which didn't create big losers.

A case of something which I think was very successful in the end, but which was far from easy going, was the reduction of the very high marginal tax rates during Nigel Lawson's chancellorship in the 1988 budget. I recall the House of Commons had to be suspended for 10 or 15 minutes because there was such as row about it. But of course, it was a case of cutting taxes and the row was basically political. It wasn't that there were individuals who were suffering from this, the individuals who were affected were benefiting. It was the general political debate that was in uproar about it. But, combined with Howe's reforms, it was a very successful programme of getting our tax rates into very similar positions to other countries' tax rates. Which is not where they started!

I think increasing the standard rate of VAT to its current rate can be regarded as a success, basically achieved by stealth, by doing it gradually over time. From an official's point of view, I'd say it was one of the disappointments that we never were able to do more on VAT.

TP: Is that regret particularly about the broadening of the base?

TB: Broadening the base, yes. We'd much rather have broadened the base than have the rate go quite as high as it did. Doing everything other than food at a lower rate was looked at various times, and apart from picking off the odd thing it didn't make it.

There was also a constant battle to reduce the value of car-related allowances, which was successful. They were not enormous sums of money, but a lot was achieved in reducing tax relief for business cars and fuel costs. More generally, over the years I would say quite a lot of inroads were made into those things which are benefits in kind during the time that I was there.

TP: On things like broadening the VAT base, at what point in the budget process do these proposals get dropped?

TB: I would say in this middle period of budget making. They were real possibilities at one point, but they were never there very close to the end, because of the political difficulties we've spoken about. Budgets, of course, were heavily negotiated between No.11 and No.10 in my day. When we had a spring budget, we would go to Chevening in the first or second week in January for the weekend with the Revenue team and Treasury team and ministers. When I was chief economic adviser, I used to write macroeconomic background notes about what we should be looking for in terms of the overall giveaway or takeaway. And we would come out of that weekend with a reasonable rough cut of the things that were runners. And we would then have a discussion with the prime minster, quite early after Chevening, about how it was shaping up. That was the general pattern. And that was No.10's chance to have their say as to whether any of the things that had come out of the Chevening weekend were regarded as go or no-go. And then, as each part – either direct taxes or indirect taxes or whatever – were sorted out, a note would be sent to No.10.

I'd say No.10's interference in this process tended to be more at times when you were putting up taxes than when you were reducing them. They were much more on alert and they much more wanted to be involved, often in some quite small details, when it came to raising taxes. They were also often very much concerned about corporation tax and the impact on small businesses, because this was an area where you could often have adverse political consequences that were much bigger than the revenues that were at stake. The odd change would be taken right at the end, but there would usually be two or three weeks where you were then doing budget speech and briefing notes and income distribution effects etc. So, there was a lot of interaction. And then from the early 1980s there was a pre-budget Cabinet meeting. I attended almost all of them – and they would go around the table with all of the Cabinet members saying what they thought should be in the budget – whether we should give away or not and which taxes might go up or down. It wasn't a terribly enlightening thing, as most of the people who were speaking relied on being briefed by their departments or had been nobbled by Treasury ministers.

JM: In what period did these Cabinet meetings take place?

TB: Certainly, the Lawson years, I would say it may have followed the '81 or 82 budget, when there was quite a lot of opposition from some members of the Cabinet. I went to a lot of these Cabinet meetings, sitting at the back. They would more or less go around the table, 20-odd people would have their two pennies worth. And it was helpful, from the point of view of judging which way the wind was blowing. I mean, that was the main thing about it. Because I understand, until then, Cabinets were not involved in budget at all until they were told about it on the morning, which of course often still happens.

TP: And we seem to have gone back in that direction?

TB: Yes! [laughs]

TP: Based on your experience, do you have a reflection of what an ideal tax policy making process would look like? Or at least which bits were helpful and which bits weren't?

TB: Well, I'm still wedded to this general notion of the wider tax base and the lower rather than higher marginal rates. I still tend to judge changes in those terms. I also tend to be rather unsympathetic to simply taxing those things you think are bad for people and reducing taxes on those things that you regard as good for people. In other words, a kind of incentives approach to taxation. On the other hand, I'm not a great believer in flat, all-taxes-should-be-the-same-level, because the nature of some products means they've got a greater tax capacity than other products. And those things have got to be traded against one another.

In general, I would say budgets shouldn't have much of an impact on income distribution unless it's actually an objective of the budget to do that: it shouldn't be an accident, you should try to balance things off so that at a normal time you would not be making too much of a change to income distribution. Now, some would say it's inevitable, like with the reduction of the very high tax rates during the Thatcher government. For a long time, of course, one of the problems about doing much on VAT was its direct effect on the price level at a time when inflation was very high, and the battle against inflation remained a primary policy objective. It did put some constraints on the ability to take measures which had a direct impact on the price level. Later, this became less of an issue because the inflation rate became much lower. Indeed, in more recent years we've been struggling to keep the inflation rate up rather than down, which is not an event I expected to see in my lifetime! [laughter]

Obviously, all of this was against the macro background where we were making decisions about trying to establish whether, in the long-term, we were on a fiscally sustainable path or not – the sorts of things that the OBR [Office for Budget Responsibility] now do. And, of course, it turns out to be more difficult than you might think. There are periods when the economy grows quite strongly and other times when it grows more slowly. And then there are these extraordinary periods when tax revenues are greater than expected, given levels of sales, incomes etc. And then, there are other periods when they fall short. This was always something that I could never quite get to the bottom of, and I notice it still goes on, where suddenly you're getting three or four years of really quite buoyant taxes, and then you have three or four years when, all things being equal, the taxes are not coming in. And it's surprising, when you would have thought that it's something you could compute quite easily from macro variables, but it turns out to be more difficult than that.

There were various experiments over time about having low starting rates of income tax rather than one standard rate. It's one of these things where people think the consequences will be rather different to what they actually turn out to be. I mean, I am now plunging to the depths of my memory, but lower starting rates of income tax don't necessarily only benefit the people on the lowest incomes because they feed all the way up the income distribution. There are a number of common ideas which people who are relatively new to tax policy reach for as what looks like a simple truth; the tax system is full of these paradoxes where you get slightly surprising outcomes relative to what you might expect.

Raising revenue is not a simple matter of just putting up tax rates: people change the balance of their spending; people find ways of turning income into less heavily taxed ways. What on the face of it seems a simple idea, that if you want to raise more taxes you just put up tax rates, is actually not quite as straightforward when you take into account not only avoidance, but some of these unexpected things that happen. And for some of those measures you can get public resentment, which means they won't fly politically. So, I learnt a lot of those things watching this process.

I came to the view that, basically, the job of the tax system was to find an efficient way, subject to all of the political constraints, of raising the amount of revenue that had to be raised in order to fund the public expenditure that other policy decisions had led to. And my heart is still in the belief that the wider the base you can have with the fewer exemptions of one kind or another combined with the lower the marginal rate you can have, then the more likely it is that you will be able to raise that money. Even then, you can run up against pressures if you try to do anything too quickly.

TP: During your time in the Treasury, was your impression that economists had quite a big role in that space, or an insufficient role?

TB: Well, it depends. They had a big role in terms of the macro issues. We also had a group of economists who were supporting the tax policy team. If we were getting different results from the Revenue to what Treasury expected, they would try to see why that might be the case, and generally support the team. And sometimes they wanted to think about some tax changes before they went to the Revenue with them.

Of course, one of the things I haven't mentioned was the experience about the poll tax and council tax. Nigel Lawson was very opposed to the community charge (poll tax), but lost the argument. Council tax was, very rarely, a tax which was not developed by the Treasury. It was a tax that was decided by the department Michael Heseltine took on [Department of the Environment] when he came back into government after Mrs Thatcher resigned and John Major became prime minister.

Having said that, Treasury were reasonably heavily involved in the design of the council tax, in particular, the big issue of the extent to which council tax bands should be national or local. The question was whether you should have different bands in different parts of the country? The Treasury wanted, as far as possible, to have national bands. This was one of the reasons why you ended up with the bands not increasing proportionately, because otherwise people with quite modest houses in London would have ended up with council taxes as high as people in very big houses somewhere else in the country. The need to have a national system and to get around the London problem led to the band system we ended up with.

JM: When the council tax system was developed in the '90s, did you envisage it would last as long as it has?

TB: Well, I was very closely involved. It was almost the last thing I did as chief economic adviser. I had to try and help to sort out this great divide between the department which wanted basically a locally based tax, if I remember, and the Treasury which wanted it nationally based. I constructed a spreadsheet model that we could play around with. The Department of the Environment had a model which delivered council tax rates, different bands in massive detail, but it could only run once a day overnight [laughter]. I was trying to build a spreadsheet model that would largely replicate the big one.

Never in a million years would I have expected the bands that were designed at that stage to have lasted as long as they have. The reason it's happened is for the same reason that got them into the mess in the first place, which was because the old rating system had got so far out of date that nobody dared update it. And therefore, they decided to have a new tax, and that exploded. So, you put in a new one and it's never been the right time to make any changes to that either.

Another place where we struggled was on capital gains tax. Nigel Lawson tried to make capital gains tax rates the same as income taxes, and I also remember a period when we tried to revalue the base cost of assets, for capital gains tax purposes. Most of the Lawson tax reforms survived, but capital gains tax got turned over quite quickly. I think by the early '90s we ended up with a system whereby you have a lower capital gains rate than income tax rate. I don't think that has ever been satisfactorily resolved, in operational terms, economic terms or conceptual terms.

TP: Given your reflections on tax reform, what advice would you give to your successors at the Treasury to support the government to successfully reform the tax system?

TB: Well, I'm not sure I can offer much advice here. The main thing is that you have to look quite a long way ahead to achieve tax reform because none of these significant reforms can be done very quickly. If they are significant, you've probably got to bring them in gradually, and even if you want to make significant changes, you probably have to bring them in slowly. And so, it means thinking quite a long way ahead about which taxes are buoyant, which ones aren't and the way you might be able to do some widening of the base. There's a bit of a tendency always to just turn up and do this year's budget. We have a multi-year public expenditure system, but we don't really have a multi-year tax programme, whereby you might set out ahead the reforms you would like to do.

Looking to the future, some taxes are obviously less buoyant than others. I assume tobacco tax is not very buoyant; in time, fuel duty is going to have its problems if we are successful in terms of limiting emissions. What are the taxes that are going to replace those? Is there any more widening that can be done somewhere? Or are there new activities which can be taxed? Most things in political life benefit from a programme which goes some way ahead, and where you try to identify where the strains and stresses are and what it is you might do to correct them. Now, it certainly didn't happen in my day. It was essentially a year by year thing, although, as I’ve tried to say earlier, it was within quite a well-specified framework that the government wanted to achieve.

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Institute for Government
2 Carlton Gardens, London SW1Y 5AA
United Kingdom

Tel: **+44 (0) 20 7747 0400**
Fax: **+44 (0) 20 7766 0700**

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