Mile End Institute
John Smith’s Shadow Budget 1992 - Myths and Lessons for Labour

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This paper, by a former advisor to the ex-Shadow Chancellor and Labour leader John Smith, revisits the ‘Shadow Budget’ during the 1992 general election.

A famous moment of political theatre, Smith used the Shadow Budget to outline Labour’s tax and spending plans. These included tax and national insurance rises on higher earners to pay for child benefit improvements and the restoration of the link between pensions and earnings.

The Shadow Budget has become mythologized in British politics after John Major’s surprise 1992 majority. It directly inspired New Labour’s fear of raising taxes and has shaped the politics of tax and spending since.

But the myth ignores the specific historical context: the 1988 ultra-Thatcherite tax and welfare cuts, the early 1990s recession, the replacement of Margaret Thatcher by John Major, the Maastricht Treaty and the politics of Europe, the Conservatives’ repeated ‘tax bombshell’ attacks on Labour’s Policy Review and alleged spending pledges, and the Party Leadership’s reluctance to counteract increased borrowing. The paper recovers these contexts by tracing the evolution of Labour’s 1987-1992 period in opposition, it’s policy development and commitments.

The paper also disputes the argument that the Shadow Budget lost Labour the 1992 election.

Finally, the paper draws lessons from Labour’s defeat in 1992, the Shadow Budget and opposition economic policymaking.

- The need for Labour to have a clear macroeconomic framework, with credible fiscal rules that are sufficiently flexible to respond dynamically to changes in UK economic performance.
- What Labour does during the lifetime of a Parliament usually matters far more than the final weeks of an election campaign.
- The benefit of ‘offshoring’ policy thinking to sympathetic think tanks, to avoid tying down Labour’s Front Bench and limit the scope of exaggerated costings by the Conservatives.
- For an opposition to win a reputation for economic competence in the UK’s Parliamentary system is extremely hard. More often governments lose it.
Thirty years ago, on March 16th, 1992, Labour’s Shadow Chancellor John Smith delivered his Shadow Budget. Speaking in a wood-paneled conference room of the Institute of Civil Engineers, Smith exuded competence and the reassuring manner of a trustworthy bank manager.

I have long felt that those who argue that the Shadow Budget was a major cause of Labour’s 1992 election defeat are misguided. And that they ignore important lessons about the Party’s period in opposition from 1987 to 1992 that are still relevant today.

To fully understand the origins of the Shadow Budget one must go back to Labour’s election failure in 1987. In Neil Kinnock’s first election as leader, despite a widely praised campaign, the party failed to recover much ground from its heavy defeat in 1983. Tax issues featured prominently, and Labour struggled to counter Tory attacks claiming that our policies were inflationary, muddled, and unaffordable. The Conservatives used a well-established campaign tactic of producing exaggerated costings of Labour’s spending pledges from dating back at least to the 1950s.1 Polling showed that Labour had not established public confidence in its ability to handle the economy, and nearly half of voters thought it was making promises the country could not afford.2

In March 1987 the Chief Secretary to the Treasury, John MacGregor, published a £34 billion costing of Labour’s programme which gained substantial media coverage. Two weeks into the election MacGregor updated the costing to £35 billion, and Chancellor of the Exchequer Nigel Lawson claimed this would require income tax rates of 58% or VAT at 50%.3 In fact, Labour’s proposals formulated by the Shadow Chancellor Roy Hattersley consisted of a £6 billion anti-poverty programme financed by reversing Tory tax cuts. MacGregor’s initiative for jobs funded by extra borrowing, and a £3.6 billion anti-poverty programme financed by reversing Tory tax cuts given to the richest 5% since 1979. Hattersley claimed that tax increases would not affect anyone earning less than £500 per week. However, this message was undermined by confusion between Hattersley and Kinnock over the details of the package (notably on the future of the married man’s tax allowance) and conflicting statements about the number of people affected.

These missteps did nothing to assuage public doubts about Labour’s competence to manage the economy. Predictably the Daily Mail and Express jumped on these errors with headlines about Labour’s “Tax Lies” and “Labour’s Tax Fiasco” which the Tories aggressively amplified in the final days of the campaign. On June 11th the Tories won again holding 57% of seats with 43% of the vote.

One month after the election Emma MacLennan wrote a confidential note for Labour’s Policy Directorate to try to learn lessons from the mistakes of the 1987 election. The paper reflected frustration that Labour’s Research Department had been underused by Roy Hattersley’s Treasury team and that their warnings about “potential problem areas were skirted over.” Notable amongst these was the failure to properly understand the impact of the abolition of the Married Man’s Tax allowance. This exposed weaknesses in the costings of Labour proposals and caused the confusion between Kinnock and Hattersley. “In future” she argued, “we should stick to one or two key aims, or we should release the full details of our policies. Our solution in the 1987 campaign was the worst of both worlds – we published enough detail to create anxiety about the effects of our policies, but not enough to dispel people’s fears.” She then recommended that a “detailed and watertight package of policies should be published well before the next election – and we need to have worked out beforehand the effect of our policies on different households.”4 In a further note “On the Language of Tax Reform” MacLennan argued that Labour should shift the debate on tax towards the principles of fairness, reduced complexity and enhancing growth.5

To lead a fresh approach to the economy and taxation John Smith was appointed as Shadow Chancellor of the Exchequer in July 1987. A cabinet minister in the previous Labour Government and a lawyer with a strong reputation for mastering a brief, Smith was determined to avoid repeating Labour’s tax muddle of the 1987 election. Number two in the Treasury team was Gordon Brown, newly elected to the Shadow Cabinet, supporting Smith in the post of Shadow Chief Secretary. Part of Brown’s role was chairing a new “Economic Secretariat” to bring together front bench researchers and the party’s Policy Directorate. This work was assisted by a group of key external advisers coordinated by John Edswell (Neil Kinnock’s economic adviser), and Andrew Graham (John Smith’s Economic Adviser). Meanwhile Neil Kinnock was determined decisively to modernize Labour’s image and its policies. He was convinced that Labour had not done enough to distance itself from the legacy of 1983 election defeat and its manifesto proposals for an £11 billion jobs stimulus, import controls, withdrawal from the European Community and unilateral nuclear disarmament – famously dubbed by Gerald Kaufmann “the longest suicide note in history”. Although Kinnock had acted courageously and decisively to confront the hard left when he denounced Militant in 1985, opinion polls still showed that the public viewed Labour’s policies as too extreme and out of touch. To overcome this gap, in October 1987 Kinnock launched a comprehensive reassertion of the party’s policies. It was intended to be a policy review “unlike any other undertaken by a political party in Britain” and develop a “forward-looking vision a more just and efficient society.”

Smith was determined to avoid repeating Labour’s tax muddle of the 1987 election by masterminding a forward-looking vision a more just and efficient society.6

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The two-year Policy Review was structured around seven thematic groups each co-chaired by members of the Shadow Cabinet and Labour’s National Executive. It was deliberately conceived as a ‘joint policy’ process that brought together Labour’s front bench teams and the Policy Directorate. John Smith co-chaired the Economic Equality Group (EEG) that dealt with tax and welfare issues. Giving Smith the primary role in the EEG was clearly motivated by a concern to avoid the errors made in the 1987 election: Emma MacLennan and I served as the Group’s Joint Secretaries. Bryan Gould (then Shadow Secretary of State for Trade & Industry) co-chaired a group on ‘A Productive and Competitive Economy’ (PCE). To ensure that the Treasury team retained a strong influence on broader economic issues, Gordon Brown, then Shadow Chief Secretary, was appointed to Gould’s PCE group.

As the Policy Review began its work, however, the Thatcher Government took decisions on tax that would have a profound political impact and huge influence on Labour’s policies. In March 1988, Nigel Lawson, the Chancellor of the Exchequer, delivered a ‘tax reforming’ budget which cut the basic rate of income tax from 27 to 25% and then cut the top rate of tax from 60 to 40%. Labour’s new Budget Response Unit - established by Emma MacLennan and John Eatwell with the strong support of Gordon Brown - had taken over the Shadow Cabinet room. With the assistance of Professor Holly Sutherland, the late Professor Sir John Hills, and other key advisors they were able to calculate the household impact of these various cuts. Lawson’s announcement of dramatic cuts to marginal tax rates caused angry protest from Opposition MPs and interruptions that led to a 10-minute suspension of the House. During this interval the Budget Response Unit managed to calculate the impact of these cuts on various income groups and pass a note to the front bench.

This gave added force to a powerful reply from Neil Kinnock as Leader of the Opposition. He angrily condemned “the immense injustice of the attitude taken by the Chancellor of the Exchequer in his view of the best-off people in our society and the gift, in excess of £2 billion a year, awarded to them in tax concessions”.

Recalling that Tony MP had cheered loudest at Lawson’s “monumental concession to the best off” he contrasted gains of £200K per week to someone who earns £1,000 per week with just pennies and a few pounds for those on low incomes.

The following day John Smith opened the debate on the budget resolutions in consecrating form. Describing Lawson’s budget as “an outrage,” he added for good measure that it was “immoral, wrong, foolish, divisive and corrupting.” Equipped with a detailed overnight budget briefing, Smith revealed that 50% of all tax cuts had gone to the top 10% of taxpayers, whereas the bottom 50% got just 10% of Lawson’s fiscal largesse. He also pointed out that taxes as a percentage of GDP (at 38%) remained unchanged. Since 1979 all the Tories had done was to shift the tax burden onto VAT and national insurance which fall predominantly on low-income groups. “It is not right”, he argued, “to slash the rates of tax for the highest paid and redistribute the tax collected to the tune of £2 billion and give it all—every penny piece—to those whose earnings and wealth have already been ostentatiously increased in recent years. No Budget in this century has more savagely redistributed the proceeds of taxation towards the super-rich.”

Smith also disputed Lawson’s claim to be a tax reformer in failing to remove the upper earnings limit (UEL) for national insurance contributions. With the top rate of income tax dramatically cut the unfairness of the UEL became an even more glaring anomaly. “We shall have in this country”, Smith explained, “a combined tax and insurance system that will start at 30%, move up to 34%, drop again to 25% when one reaches £16,000, and then increase again to 40 per cent. Is that supposed to be some kind of logical and cleverly designed, sensibly constructed policy for income tax rates and national insurance contributions?”

Unsurprisingly, Labour voted against Lawson’s budget for the rich and its blinkered injustice gave both Smith and Kinnock confidence that they could win the argument for fairer taxes.

Closely following the Tony’s top rate tax cuts was the entry into effect of income-related benefit cuts arising from the 1986 Social Security Act. One month after Lawson’s budget, changes to means tested benefits created high numbers of losers in the poorest fifth of the population. This came on top of the freeze in the value of child benefit and the break between the rise in earnings and the level of the state pension. The Tories welfare reforms were the ugly other end of their tax cutting agenda and came under strong attack from Labour’s front bench.

In a 13th April debate on the social security system Robin Cook, then Shadow Secretary of State for Health and Social Security, spelled out the consequences. “We would not want it to be thought that this Government have been idle over the past nine years. In that time, they have abolished the link between pensions and earnings, which means that the pension for a married couple is £14 less than it would otherwise be. The Government have also abolished the short-term sickness benefit and the earnings-related supplementary unemployment benefit, and they have taken all of unemployment benefit into taxation. They have repeatedly not uprated child benefit, so that it is now worth almost 10 per cent less than it was worth in 1979, in real terms.

We know that the Government had the money to prevent there being any losers. We know that because the Chancellor found £2,080 million to give to 750,000 top rate taxpayers only last month. There was no talk of targeting there in the Budget speech, no talk of concentrating help where it was most needed last month. The Chancellor actually gave away more money to 750,000 of the rich than the entire increase in the social security budget for 12 million claimants. That tells us all that we need to know about the Government’s priorities. This is a Government who help the rich and punish the poor and it is against those priorities that we shall vote tonight.”

Together with the hated poll tax, the 1988 budget and the social security cuts represented the apotheosis of Thatcherism. Lawson’s exuberant claims to have achieved an economic miracle soon turned out to be an unsustainable boom followed by a deep recessionary bust. A foolish decision in the 1988 Budget to delay until August limitations on mortgage interest relief also further stimulated an already unsustainable surge in house prices. With the economy overheating, in real terms. They have removed the board and lodging allowance from all claimants under 25 on social security and, worst of all, over the past two years they have just about halved expenditure on single payments. That is quite a record.”

Cook concluded his speech with a powerful comparison, “Here we come to the final and shaming contrast—the contrast between tax cuts in March and benefit cuts in April. There need not have been any losers from the social security changes. They have repeatedly not uprated child benefit, so that it is now worth almost 10 per cent less than it was worth in 1979, in real terms. They have removed the board and lodging allowance from all claimants under 25 on social security and, worst of all, over the past two years they have just about halved expenditure on single payments. That is quite a record.”

The 1988 budget and social security changes together with Labour’s full-throated response set a clear benchmark for the Party’s Policy Review. Its initial interim report entitled ‘Social Justice & Economic Efficiency’ was presented at the Labour
In March 1989, ahead of the Tory Budget, Smith launched a £3 billion Labour package that was designed to help the low paid in contrast to the largesse that Lawson had showered on the rich in 1988. In line with the approach of the Policy Review, he proposed to reverse the real value of child benefit, generously upgrade personal tax allowances and reform the National Insurance system. Meanwhile the deterioration in the economy from boom to bust was now clear and the Conservative’s election winning streak since 1979 started to look shaky. By May Labour had established a consistent opinion poll lead over the Tories.

This was confirmed by Labour’s victory in the June 1989 elections to the European Parliament. The Party overtook the Conservatives for the first time in any election since October 1974, winning 38% of the vote. In July Labour enjoyed a 12-point opinion poll lead and in the same month the major report of the Policy Review entitled ‘Meet the challenge. Make the change’ was published. Its highlights were dropping commitments to nationalization, nuclear disarmament, and withdrawal from Europe; a ‘supply-side’ agenda of economic reform, and clear priorities for tax and welfare reform.

The Policy Review chapter ‘A Fairer Community’, prepared by the Smith-led EEF, unequivocally advocated reversing tax cuts for the rich and reducing the heavy burden of tax for those on low and average incomes. The aim was to position Labour as a fair tax party and not a high tax party. It attacked Tory increases in VAT (doubled early in the Thatcher’s first term of office) and National Insurance Contributions (NICs) which had risen from 6.5 to 9%. Instead, Labour would reform income tax rates by introducing a series of tax bands ending in a top rate of 50%. The review group also committed to addressing the highly regressive nature of NICs by abolishing its upper ceiling. It confirmed ‘pathways out of poverty’ proposals to at least raise the state pension by £5 for a single person & £8 for a married couple, increase child benefit, and introduce a national minimum wage.

So, by July 1989, Labour’s had established core commitments on tax and welfare reform driven by one the one hand Parliamentary opposition to Tory tax and benefit cuts, and on the other by the Policy Review. These were then approved at the Labour Party Conference that Autumn as part of the endorsement of ‘Meet the challenge. Make the change’. For Kinnock and the Labour leadership this represented an essential effort to re-position the party’s policy agenda to move beyond the successive defeats of 1983 and 1987. It was successful in doing so. The definitive study of the 1992 election, ‘Labour’s Last Chance? The 1992 Election and Beyond’ (based on British Election Survey) concluded that, “the electorate did notice that Labour had moved to the center, and they did feel that Labour was a more moderate and, we may surmise, more electorate party than it had in the 1980s”.

Smith was not directly involved in drafting the economic chapter of the Policy Review ‘Competing for Prosperity’ led by Bryan Gould. For the Treasury team this task was delegated to Gordon Brown. Focusing on supply side improvements to tackle weaknesses in UK productivity and competitiveness, the PCE group proposed a medium-term industrial strategy to invest-led growth that would feature support for research and development, regional measures, skills, and training. This approach recognized that previous attempts to ‘dash for growth’ in the 60’s and 70’s had failed largely due to supply constraints caused by persistent underinvestment in the productive capacity of the UK economy.

On the delicate issue of exchange rate policy, the report was cautious about joining the European exchange rate mechanism. This reflected the well-established skepticism of Gould about the ERM and the European Community in general. This perspective was not shared, however, either by Neil Kinnock or John Smith who saw the ERM as emblematic of Labour’s more pro-European approach and as a credible anchor for Labour’s anti-inflation policy. Both Kinnock and Smith wanted to support ERM entry but were fully aware of the risk of joining at an uncompetitive rate. This, of course, is exactly the mistake made by the Conservatives when they eventually joined the system in October 1990.

So, in parallel to the Policy Review in June 1989 the Shadow Cabinet’s Economic Sub-Committee developed a more positive but conditional approach to the ERM which was reinforced by a high-profile visit by Smith and Treasury teams to European capitals in October that year. Also significant was a reshuffle of Labour’s front bench that Autumn, when Gordon Brown was appointed to the Trade & Industry role replacing Gould who was moved to the Environment. Unlike Gould, Brown fully supported the pro ERM position adopted by Kinnock and Smith.

It is striking that the Policy Review was notably tight-lipped on macro-economic policy. The PCE group rightly condemned “the government’s fateful experiment with monetarism” and swing from unsustainable consumer boom to reliance on high interest rates that further damaged the supply side of the economy. In contrast Labour’s macro-economic thrust would aim to achieve ‘a better balance between consumption and investment’. There was no reference at all, however, to the public sector borrowing requirement (PSBR) or any description of fiscal rules. Indeed, the introduction to the Policy Review, signed by Neil Kinnock, included a section on public investment. In four key paragraphs, drafted by John Eatwell, the importance of economic growth to create extra resources for investment and consumption was highlighted. Warning that “the country would not benefit from any commitment that exceeded its capacity to meet the cost” it was confirmed that “the objectives set out in the Policy Review will necessarily depend on achieving economic growth”. For added emphasis it was stated that, “We will not spend, nor will we promise to spend, more than the country can afford”. This crucial text sought to clarify Labour’s macro-economic stance which had not been adequately addressed by the PCE group. Finally, the introduction confirmed that “At the time of the next General Election, we will set out the accurate costs of our manifesto proposals in the light of the economic situation we are likely to inherit and the priorities which we consider most urgent”.

In effect, therefore, the Policy Review committed Labour to
leave unchanged the level of the PSBR it would inherit at the next election. This was a significant shift from the additional borrowing required for Labour's economic plans in the 1983 and 1987 manifestos. It marked a further retreat from Keynesian demand management which had been dramatically signalled by Labour's Prime Minister Jim Callaghan in the wake of the UK's 1976 balance of payments crisis and the public spending cuts demanded by the International Monetary Fund.

In a speech to the Party Conference in Blackpool that year Callaghan rejected deficit spending to counter a recession arguing "in all candour that that option no longer exists." 12 In my opinion, however, neither Kinnock nor Smith (appointed to Labour's Cabinet in 1978 by Callaghan) ever subscribed to the former PM's blunt rejection of Keynesian economics. Rather they were pragmatically reluctant to open further possibilities for another predictable Tory onslaught on alleged Labour profligacy. These decisions, however, were very important in circumscribing Labour's options ahead of the Shadow Budget and the 1992 election.

"Meet the Challenge, Make the Change" was, of course, about much more than tax and the economy. It was a comprehensive recasting of Labour entire policy programme. Inevitably this made it an easy target for Conservatives to attempt a repeat of John McGreggor's exaggerated costings of the 1987 election. Labour's Treasury team were very conscious of this risk. It became an important priority for Brown and the Economic Secretariat to try to disarm the all too likely Tory costings exercise. Brown knew, as we all did, how difficult it is to give any front bench team to effectively oppose the government on any measure without at least implicitly endorsing its reversal with possible spending implications. So, a key task was to avoid giving ammunition to Conservative Central Office or to the Treasury which - in my view improperly - has assisted Ministers in preparing costings of opposition policies.

To some extent this effort succeeded. In July 1989 just after the release of the Policy Review the then Permanent Secretary of the Department of the Environment, Sir Terry Hesseler, drew up an internal memorandum that was leaked to Gordon Brown. Hesseler warned that: "The Labour review document has been drafted much more carefully than on some earlier occasions. The promises do not readily lend themselves to precise costings. And in most cases the assumptions you have asked us to cost are vulnerable to counterattack from the opposition." 13 This was encouraging but we were under no illusions that the Conservatives would not try to come up with dubious costings of their own. Inevitably, in an 80-page report covering a huge range of policies it was almost impossible to entirely avoid hostages to fortune. The document included many quasi-commitments that Tony Ministers and their special advisers would try to cost even if civil servants were reluctant to do so.

Meanwhile the wheels were starting to fall off the Conservative's economic policy. Struggling to find a credible counter inflation strategy, Lawson opted to shadow the Deutsche Mark and tried to persuade a sceptical Margaret Thatcher to join the ERM against the advice of her economic adviser Sir Alan Walters. Smith relentlessly mocked the deep divisions at the heart of the Tory government. Thatcher had attempted to dismiss the disarray by claiming that "Nigel is a very good neighbour of mine, and a very good Chancellor". In a Commons debate in June Smith gave a wily and acerbic report calling Lawson "the nominal Chancellor of the Exchequer" and even singing a verse from the theme tune to the popular soap opera 'Neighbours'. 14 With open warfare declared between Number 10 and 11, Lawson's renunciation was inevitable and happened on 27th October just days after Smith had taunted him in the House of Commons to "jump before he is pushed". 15 In November, following Gordon Brown's promotion to Shadow Secretary of State for Trade and Industry, a successor had to be found as Shadow Chief Secretary. On the advice of Smith, Kinnock appointed Margaret Beckett. Smith's support for Beckett was strongly endorsed by Emma MacLeannan. She had worked closely with her and admired Beckett's ability to make hard-headed choices whilst serving as front bench spokesperson on social security issues. A former scientist trained to use the electron microscope, Beckett had few qualms about keeping a close eye and tight discipline on the party's spending commitments.

In 1990 the Economic Secretariat, now chaired by Beckett, carried out an analysis of the Policy Review to try to anticipate a hostile Tory costings attack. Helping with this work was a young Oxford graduate on a short-term contract working in John Smith's office. Her name was Yvette Cooper. The Treasury team were concerned that despite the 'affordability' caveats included in Neil Kinnock's introduction to the Policy Review it was still vulnerable to misrepresentation by the Conservatives. To reduce this risk Margaret Beckett applied the phrase 'as resources allow' to all the Policy Review's implied additional spending. The only exceptions to this catch all restraint were the pledges to raise the state pension and child benefit. This became nicknamed as 'Beckett's Law'. It was hoped that by entrencing these two measures as core commitments it would be easier to dismiss the expected tactic of Conservative costings attack on Labour. Meanwhile the much taunted Tory economic miracle was turning out to be a mirage. In 1990 inflation hit 9.3%, bank lending rate reached 13.8% and GDP growth fell to just 0.5% as a deep recession and rising unemployment loomed. The year caliminated in Tory turmoil with the dramatic downfall of Prime Minister Margaret Thatcher. In reaction to her increasingly autocratic style, the disastrous impact of the poll tax, and disputes over the ERM with her former Chancellor Nigel Lawson and Foreign Secretary Geoffrey Howe, Thatcher was ousted by her own MPs in November 1990. Her removal from Downing Street transformed the political landscape: John Major, Thatcher's successor as PM, was a very different personality, declaring that he wanted to make a Britain 'a country at ease with itself'. His approval ratings ran higher than the Conservative party, far higher than Thatcher's in 1990, and better than Kinnock's. 16 Labour's previous opinion poll lead narrowed and by November the Tories took a narrow lead.

In 1990 Major acted to abolish the hated poll tax, defuse Tory disputes over Europe (albeit temporarily), looked statesman-like during the first Gulf War, and crucially gave the impression that after ten years of Thatcherism the country had experienced a significant change of leadership. Labour did well in the local elections in May but still failed to retain its previous opinion poll lead over the Conservatives. With the economy still mired in deep recession, Major was reluctant to risk an election, and hanging on into the fifth year of the Parliament became increasingly inevitable. Tax and spending issues would feature prominently in this long campaign.

In May Smith attacked the government's record on tax and accused the Conservative's of having a "hidden agenda" to raise VAT. Norman Lamont, Major's successor as Chancellor of the Exchequer, had in March already increased VAT to 17.5% to finance a £140 reduction per head in the poll tax. Smith challenged Lamont to explain how the Conservatives could contemplate their avowed ambition of reducing the basic rate from 25 to 20% without either cutting public spending or raising VAT. Smith argued that: "Such a switch from direct to indirect taxation would require an increase in VAT from the current 17.5% to 22%." In June the then Chief Secretary David Mellor launched another bid to discredit Labour's tax and spending policies. Appearing with Tony Chairman Chris Patten under a poster 'Labour's going for broke again', Mellor claimed that in a full year Labour's spending commitments added up to £35 billion. This was based on a list of 46 supposed Labour 'pledges' identified by Warwick Lightfoot, a Conservative Special Advisor, and then costed by

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13 Andy McSmith, John Smith: Playing the Long Game (London: Verso, 1993), p. 120.
Treasury officials. In his biography ‘In Office’ Norman Lamont argued that “Labour were wide open to attack”. One of Treasury officials. In is biography ‘In Office’ Norman Lamont to alter its policy package to reduce any negative impact on that around 70% of respondents believed they would pay more Deborah Mattinson gave a presentation to the Shadow Cabinet increase taxes for everybody”. Again in 1990, Gould’s colleague, had established in mid-1990, pressure was mounting on the Labour leadership and Smith to modify Shadow Communications Agency (SCA) and polling research. With Labour seemingly unable to recover its previous opinion lead it had established in mid-1990, pressure was mounting on the Labour leadership and Smith to modify the tax and welfare reforms that the party had agreed in 1989. The main exponent of a change was the late Philip Gould, the former marketing executive that was responsible for Labour’s Shadow Communications Agency (SCA) and polling research. Gould and the SCA had consistently warned that Labour was highly vulnerable to attack. In April 1988 the SCA had shown Smith their private polling which suggested that “Labour would increase taxes for everybody”. Again in 1990, Gould’s colleague, Deborah Mattinson gave a presentation to the Shadow Cabinet that around 70% of respondents believed they would pay more tax under Labour. Gould also believed Labour would have to alter its policy package to reduce any negative impact on ‘aspirational classes’ which the British Social Attitudes survey estimated comprised 50% of the UK population. In his book ‘The Unfinished Revolution’ Gould subsequently wrote that “a period of estrangement between John Smith and the SCA resulted”. Gould is very careful in his account of his relationship with Smith, and he also believes that public trust would be fatally undermined if these policies were to be dropped after three years of constant repetition. And he could not comprehend how it would be possible to go ‘empty handed” into an election no longer predicting the increase in the state pension and child benefit that we had declared to be core commitments. The party membership’s acceptance of the Policy Review was, in his mind, a kind of contract that had to be honoured. For Smith, deploying the transparency and building trust was the best way to overcome the entire pressure was mounting on the Labour leadership and Smith to modify the tax and welfare reforms that the party had agreed in 1989. The challenge for Smith was how to meet the Policy Review promise “to set out the accurate costs of our manifesto proposals” at the time of the General Election. The transparency Smith wanted to achieve would require precise enumeration of the full pre-election package and that raised a difficult strategic issue of timing. On this, opinions were divided. Charles Clarke, then Neil Kinnock’s Chief of Staff, wanted to release costed proposals early. Smith, however, was not convinced. He was concerned that Labour’s plans could be upstaged and be vulnerable to sabotage by a government budget designed to wreck them. This was the unavoidable predicament and inevitable disadvantage of being in Opposition; the Government had control of the agenda and could cast the last throw of the dice. It was, therefore, decided the release of Labour’s costed policies would have to wait until the election campaign was underway. 1992 began with the Tories launching another attack on Labour costings. Chris Patten and David Mellor appeared together again with a new ‘Labour’s Tax Bombshell’ poster. It claimed that people would pay £1,000 more in taxes under Labour. The poster ran on 1,000 sites, the same theme was the subject of a party-political broadcast, and again there was coverage in the Tory sympathetic press. Meanwhile the Labour leadership was about to consider the delicate issue of how to implement the proposal to remove the NIC’s UEL. National insurance is effectively a second form of income tax. Labour’s plans to remove the UEL in combination with a new 50p top income tax rate would make the top tax rate 59%. This was 1p less than the 60p rate applied by Thatcher’s Government until 1988. Neil Kinnock wrote to Smith on 14th January and highlighted the possibility of phasing the NIC reforms. Drafted by Kinnock’s economic adviser John Eatwell, the letter explored ways to avoid a significant increase in the tax burden of those earning between £21,000 to £30,000 who had not benefitted from Tory top tax reductions. Kinnock pointed out that in the Policy Review it was always recognized that “in reforming the tax and social insurance systems we will ensure that changes are made gradually and in ways which limit the impact on personal incomes”. The problem was how to reconcile the possibility of a gradual approach with raising sufficient funding to pay for the Party’s manifesto commitments. Without the possibility to resort to extra borrowing Labour had to raise revenue from somewhere. Unfortunately, however, on the evening of the day that Smith received the letter, Kinnock hosted a group of political correspondents at Luigi’s restaurant in Covent Garden. Over dinner he raised the possibility of phasing Labour’s proposed NIC increase. Initially the significance and sensitivity of the issue was overlooked by the journalists present. Smith and all the Treasury team were left entirely blindsided when two days later Alison Smith of the Financial Times broke the story. The floodgates then opened with lurid headlines about Labour confusion over tax. This unfounded error was reminiscent of the confusion between Kinnock and Hattersley during the 1987 election. Smith was understandably furious. He had been determined to avoid repeating that mistake, couldn’t fathom how such a delicate issue had been shared with journalists, and - most frustrating of all - was willing to try to ameliorate the impact of abolishing the UEL. Smith’s anger was quickly defused, however, when Kinnock unreservedly apologized. In fact, we were exploring ways to put together a package that would be fiscally neutral, raise sufficient funding for Labour’s core commitments, and soften the reform of NICs. The proposal Smith was considering would be to remove the UEL but simultaneously cut the rate of NICs from 9% to 8%. In combination with increases in child benefit it could be shown that more voters earning above £21,000 would gain from this package. This would help to address the concern for ‘aspirational classes’ and provide a positive headline story about cutting NICs for most taxpayers. But deciding on any specific set of measures would have to wait until the Tories’ final move in an expected pre-election budget.

To try to get back on the front foot, Labour initiated a tax attack of its own. A ‘Vatman’ poster was launched on 28th January by Smith, Beckett, and Jack Cunningham. The poster featured an image of Norman Lamont wearing a Batman cape and warning voters that a vote for the Tories will mean a VAT rise to 22%. This was followed by further attacks on the ‘Cost of the Conservatives’ highlighting the Government’s poor record on growth which since 1979 had been just 1.7% compared with previous trend rate of growth of just over 2.5%. Smith showed if the UK had reverted to trend growth “every family in Britain would have been £2,200 better off in 1991 alone”. Neither Tory nor Labour attacks proved decisive in opinion polls which saw both parties level pegging in the run up to the Budget due to be held on 10th March 1992. 18Norman Lamont, In Power (London: Little Brown & Company, 1999), pp. 168-9. 19Phil Gould, The Unfinished Revolution: How the Modernisers Saved the Labour Party (London: Abacus, 1998), p. 123. 19Martin Westlake, Kinnock: The Biography (London: Little, Brown & Company, 2001), p. 529.
Lamont’s budget was the opening shot in the election campaign proper and was predictably designed to create the maximum difficulty for Labour. The Chancellor announced the creation of a 20p tax band for the first £2,000 of disposable income. It was presented as a first step towards eventually reducing the basic rate from 25 to 20%. For a government that for more than a decade had lavished tax concessions on the rich this was a cynical attempt to appear concerned about the low paid. And it was cleverly designed to be a political ruse to maximize the difficulties for Labour’s frontbench.

Kinnock and Smith both agreed that Labour should vote against the 20p band. However, this created a dilemma because in reversing the cut it would be necessary to increase personal tax allowances to ensure that the lower paid would not lose out. Neither Kinnock nor Smith could contemplate a package of Labour proposals less generous to the poor than Tony policies. But it proved impossible to both increase personal tax allowances and go ahead with the plan to cut NICs by 1%. The money for both simply wasn’t available and the possibility to soften the abolition of the UEL disappeared.

The following day John Major called the election. Smith’s Shadow Budget, and they had to stop talking about it and go back to their crude but effective Tax Bombshell campaign. And that is what they did. Rather than use Norman Lamont to argue about Smith’s plans, they switched to Prime Minister John Major and reverted to the claim that the price of Labour would be £1250 for every family. This was reinforced by another poster warning of Labour’s ‘Double Whammy’ illustrated by a pair of red boxing gloves representing higher taxes and rising prices.

Labour and Smith rebutted by launching a ‘Vatman’ banner and repeating the charge that the Tories would sharply raise VAT if re-elected. Unfortunately, there was no repetition of the VATMAN poster. Apparently, Wanner Brothers had complained about the use of the batman image, and it could not be used again! Even if it had been possible to do so Labour lacked the resources available to the Tories and their Tax Bombshell and Double Whammy posters. Meanwhile the Conservative leaning popular press loyally recycled the unfounded claims that Labour would make every family worse off.

As polling day approached Labour’s initial poll lead subsided and the election seemed too close to call. Many expected Labour to either win narrowly or be the largest party in a hung Parliament. Major’s outright victory on 9th April was a surprise. Against the trend of the polls the Tories won 42.8% of the vote, only a fraction down on their performance in 1987. Major was returned to Downing Street with a working majority of 21 reduced from 102. Labour had improved to 35.2% (a swing of 2.2%) but was still below the level of Callaghan’s 1979 defeat.

The Sun which had been vitriolic in its treatment of Neil Kinnock in the month “An uncomfortable truth has slowly dawned on Conservative Central Office: in the propaganda war over taxes and middle income C2 voters, the government was upstaged by Labour’s shadow budget and has failed to regain the initiative”. The writer was Ed Balls, and he was right. To regain their momentum the Tories would have to significantly change their tactics.

Some years after the election I met Charles Saatchi at a lunch, explained my work with John Smith, and discussed the 1992 campaign in which he and his brother Maurice had played key advisory roles. Saatchi confirmed that he had warned the Tory leadership that they were falling into the trap of debating the Shadow Budget, and they had to stop talking about it and go back to their crude but effective Tax Bombshell campaign. And that is what they did.
However, as Peter Sloman of Cambridge University has observed, the failure of Smith’s Shadow Budget has “taken on a mythical status as a justification for the ‘strategy of relentless reassurance on tax’ that New Labour pursued in (and beyond) the 1997 election.”

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As regards the top rate of tax both Smith and Brown, who had become Shadow Chancellor, wanted to retain the commitment to raise it to 50%. However, this proved to be unacceptable for Tony Blair, elected Labour Leader after Smith’s untimely and tragic death in May 1994. He insisted on retaining the 40% rate applied since Lawson’s 1988 budget. In biography Brown records his shock when he and Ed Balls visited Blair at his home in Islington. “Sitting in the garden lapping up the sun on a very bright morning we were both surprised when he announced that Labour must rule out any rise in the top rate of tax.” This marked a significant shift from Labour’s traditional commitment to progressive taxation.

With the benefit of hindsight, however, I think the reluctance focus on tax and the Shadow Budget in the 1992 election has overlooked other significant difficulties, notably with Labour’s approach to macro-economic policy. Mistakes were made in the earliest days of the Policy Review which separated vital economic issues into the EEG and PCE policy groups led by Smith and Gould. As a result, and as I described earlier, the party’s macro-economic policy was neither fully thought through nor coherently expressed. It would have been better to have had a single policy group responsible for economic issues in their entirety. This would have enabled greater prominence to be given to an overall statement of how Labour intended to manage the economy and include a set of fiscal rules that could resist Tony accusations of profligacy but be flexible enough to respond to changing economic circumstances over the course of the Parliament.

If, for example, the Policy Review had then adopted a version of Gordon Brown’s subsequent so-called ‘Golden Rule’ applied over the economic cycle, Labour could have responded more nimbly to the shift from boom to bust in the UK economy.

Unlike the party led 1987-87 Policy Review, Labour’s front bench would be free to accept or reject whatever IPPR recommended.

It is difficult to imagine how Labour – a party defined by its belief in social justice – could have responded any differently.

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Defusing the Tories oft-repeated ‘tax bombshell’ campaign proved impossible. Policy reviews and the daily grind of opposition are activities that are inevitably vulnerable to exaggerated costings. And yet Labour has to appeal to the public and enthuse its supporters by offering the prospect of meaningful change. Squaring that circle is a huge challenge. In 1987-1992 Labour did not succeed in doing so. Relevant also was the unusually long Parliament that extended into five years, giving the Tories even more time to repeat their lies about Labour’s spending commitments.

In summary the Shadow Budget did not cost Labour the election in 1992 but it clearly failed to achieve its objectives. These were bold but defensive – to undermine Tory lies about our tax plans, to reassure the public that Labour would not spend more than the economy could afford, and to leave most people better off. It did not fail because of the proposed tax & national insurance increase for higher earners. Rather it failed to nail the Tory ‘tax bombshell’ lie and was constrained by a macro-economic stance that was extremely cautious.

For understandable political reasons Kinnock and Smith were reluctant in 1987-1992 to take on arguments in favour of a more activist and modestly Keynesian fiscal policy. Arguably the long legacy of Callaghan’s rejection of Keynesianism in 1976 has inhibited successive Labour leaderships for far too long. It certainly helped the Tories get away with the sheer calumny that Labour profligacy caused the 2008/9 financial crisis. Unfortunately, neither the functioning of the economy nor the intricacies of the tax and welfare system are well understood by the public. This has always been a problem for Labour and those arguing that social justice and economic prosperity requires interventionist rather than ‘neo-liberal’ policies.

Tory conflation of the homilies of household finance with real challenges of national economic governance has always been hard to overcome, especially when reinforced by some in the national media all too capable of economic illiteracy. This problem persists and has been brilliantly exposed by Professor Simon Wren-Lewis in his book ‘The Lies We Were Told’. Wren-Lewis shows “how the media have used household analogies when discussing austerity like ‘maxed out credit card’.

In response to the austerity of 2011/12, he argues the media ignored the fact that any first-year economics textbook will tell you that such analogies are completely inappropriate and that in a recession the government should increase spending or cut taxes and not worry about the deficit.”

Recent history shows that it is very hard for an opposition to win a reputation for competence in the UK’s Parliamentary system. More often governments lose it. And in 1992 this happened dramatically on 16th September when the centrepiece of John Major’s economic policy – UK membership of the ERM collapsed. After ‘Black Wednesday’ Labour took a 22-point poll lead which it didn’t relinquish until 2006. And part of Labour’s swift ascendancy was due to Smith’s masterful handling of the ERM debacle and Major’s subsequent crisis over the Maastricht Treaty ratification. This created a superb platform for Labour’s victory in 1997. But that is another story…

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