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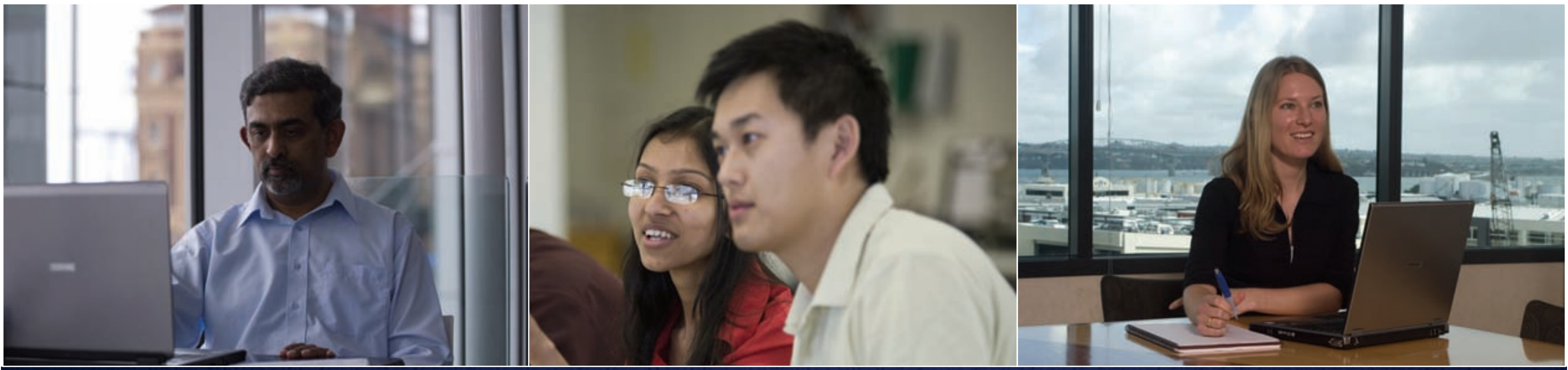

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MODELLING TAX POLICY DEVELOPMENT GOVERNOR FITZROY'S TAX REFORM 1844-45

Kevin Heagney

Te Kunenga ki Pūrehuroa

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Modelling Tax Policy Development Governor Fitzroy's Tax Reform 1844-45

Kevin Heagney[1]

Department of Economics and Finance
Massey University
Palmerston North
New Zealand

ABSTRACT

A uniquely New Zealand conceptual model is constructed to explain the process by which Governor Fitzroy accomplished New Zealand's first recorded fundamental tax reform. After theorising on what may actually have occurred, hypotheses are formed, and then a standard framework of political economy is adopted for analytical purposes. Thereafter, in an inductive manner a simple evidential model is constructed. The model is then tested for explanatory power using a later tax reform event from New Zealand economic history. The paper finds: (1), that the derived model ably describes Governor Fitzroy's process for tax policy development during the study period and (2), the model may have potential for further study of both current and future tax policy development.

JEL: N, Economic History

Key Words: Tax history; Crisis; Critical juncture; Stage model; New Zealand.

[1] Corresponding author: Email: k.heagney@massey.ac.nz. Phone: (06) 3505799 Extn. 2658.
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The objective of this discussion paper is singular: via an inductive analytical process, for the study period 1843-45, to build a conceptual model which explains the process which enabled Governor Fitzroy's fundamental tax reform – an event which included *The Property Rate Ordinance* of 1844. The problem this paper considers is namely, the lack of knowledge concerning the past development of New Zealand taxation. The question derives from Musgrave (1959, p. 5), and it is: Was there a guiding principle at work in the context of tax policy development in early New Zealand (1843-45)?

1. INTRODUCTION

Tax reform, as undertaken by Crown Colony New Zealand's second governor Robert Fitzroy in 1844-45, does not appear to have been as simple as Owens (2006, p. 131), for example, suggests: an ongoing and effortless process. The notion that tax systems continually adapt to reflect changing economic, social, and political circumstances does not do justice to the events of the study period; 1844-45 New Zealand. The mechanics of Fitzroy's reforms (the tax laws and proposals, and the consequent political debate) will be discussed in subsequent discussion papers. However, for the moment there is still no adequate theoretical model to explain how a tax policy change of such serious magnitude was achieved. This paper is a pioneering attempt to create such a model for one very early New Zealand tax reform event; namely, a model of the first fundamental tax reform in New Zealand economic history.

It is plausible to suggest that incremental tax reform is usually conducted on the basis of the theory of second best and quite are the result of conflicted negotiation within and by the polity. That political process of deliberation is often conducted by individuals or coalitions, both of whom represent interest groups. These aspects are already adequately modelled by the Force-Field Approach to the development of taxation (Lewin, 1951; James, 1997, and James, 2002, p. 108). This approach to incremental change for tax systems can be viewed as adaptive reform only and thereafter, James's explanation of incremental tax change can be considered as purely maintenance of the existing fiscal status quo. Thus, the continual process of tax policy development constitutes either peripheral tinkering, or the latest round of negotiated policy change. Both of these occur after a fundamental tax reform and also between points of economic and, institutional disjunction.

The existence of such points of disjuncture would, for example, make sense to Kuhn (1962), who comments that: Scientific advances often occur through paradigm shifts rather than incremental adjustments. A paradigm shift is an occurrence which the political science literature terms, a critical juncture (Hogan 2006). Similarly, this conceptual understanding can also be applied to fundamental (major) tax policy changes such as those which have occurred in the economic story of colonial New Zealand.

The argument developed in this paper will focus on just such a moment of disjuncture in early New Zealand, viz. the evolutionary process of tax policy development between 1843 and 1845. The method of economic analysis for the paper's core sections is inductive and therefore, the derived model does not appear until after a strong theoretical position is developed. In essence, certain key events are observed, patterns recognised, and thereafter, with the assistance of existing abstract theory, tentative hypotheses are formed. The headings (the structural elements of a conceptual theory) are then created from the tentative hypotheses. Nonetheless, let us anticipate what will follow. The headings that are subsequently developed are: (1) the *Consequence of Needs*; (2) *Institutional Change*; (3) the *Policy Formulation Method*, and (4) *Constant Disequilibria*. These headings provide the structure of a theoretical model to explain the political process undertaken by Governor Fitzroy in order to achieve a fundamental reform of Crown Colony New Zealand's tax system.

To close the discussion paper, the developed model is subjected to testing. Comparative analysis is undertaken using a second New Zealand tax reform; an event which can also be considered a fundamental tax reform. Testing is undertaken to assess the validity of the theoretical model: if the model is to have any veracity beyond explaining Governor Fitzroy's reforms, it also needs to be applicable to as many other instances of major tax reform in New Zealand as possible. However, in order to keep the discussion manageable and as the focus of the paper is not the testing of, but rather the development of a model, only one major economic reform event will be considered. The hypothesis for this discussion paper is the following: That the events of 1844 New Zealand, and the consequent tax reform, provide sufficient material to construct a theoretical model. That model should be able to adequately describe the first fundamental tax reform in New Zealand economic history.

The work is laid out as follows: Section 2 provides the theoretical foundations of the paper, and Section 3 the theoretical development. Section 4 discusses the theoretical framework, while in Section 5, the conceptual model itself is presented. In Section 6 the model is tested and the paper's conclusions are found in Section 7.

2. THEORETICAL FOUNDATIONS

The starting point for the theoretical discussion is an old idea of Feldstein (1976), restated more recently by Thorndike (2004). According to Feldstein and Thorndike, fundamental tax reform only comes about following economic crisis. This insight is something that is noted in the reasonably extensive body of literature on the subject of crisis induced tax reform. For example, reference may be made to the following: Ben-Porath and Bruno (1977); Radian (1979); Keeler (1993a and 1993b); Drazen and Easterly (2001); Tomassi (2002), and Alesina et al (2006). Even Goldfinch (1998) and Aberbach and Christensen (2001) mention crisis in respect of the economic reform process in New Zealand during the 1980's and 1990's. Crises theory was however, first developed by Thomas Kuhn. The view of Kuhn was that advances occur through paradigm shifts, i.e. points of disjuncture - also, elsewhere called periods/moments of critical juncture, a term first used by Collier and Collier (1991).

The Historical Institutionalism literature also acknowledges that a critical juncture; an entire period of significant economic change (Doyle and Hogan, 2006), generally follows a period of social political and/or economic crisis (Leiberman, 2001b, p. 526). Theoretical developments in the critical juncture field, in the past decade, can be found in the New Institutional Economics literature; for example, Goldfinch and t'Hart (2003). Even more recently Hogan (2006) made the critical juncture theory the sole focus of enquiry, and did so in a similar manner to that of James (2002). The latter, James, attempted to model the adaptive tax policy development process. Thereafter, Doyle and Hogan (2006), constructed a simple sequential model to explain the process of a critical juncture, and thus, Doyle and Hogan's work is of relevance to this discussion paper and it is discussed further below.

In Hogan's early work he develops a sequential, two-step, framework (theoretical model) to explain what constitutes a critical juncture. The model is as follows: (1) a *generative cleavage* + (2) a *change* event; which is significant, swift, and all encompassing, equals a *critical juncture*. Generative cleavage is an unanticipated event which leads to widespread tension, and triggers change. Further, exactly what constitutes a *generative cleavage* will vary, depending on the event being studied (Hogan, 2006, p. 664). For this chapter, a *generative cleavage* is considered to be a macroeconomic crisis. The events which follow Hogan's first step, a *generative cleavage*, are sequential; and they all need to occur and, in the order indicated above, for the change event to be accurately termed a *critical juncture*.

Hogan's *critical juncture* model was very quickly extended by Doyle and Hogan (2006), on the basis that other researchers/authors were incorrectly specifying the causes of critical junctures and thereafter, wrongly labelling economic events as turning points. In addition, they also considered that the available analytical models which attempted to explain a *critical juncture* lacked a predictive quality, something Doyle and Hogan considered to be less than adequate. Their new model sought to explain the *critical juncture* model of state development in more detail, viz. a three-step framework. The detail of the model is as follows: (1) *macroeconomic crisis* + (2) *ideational change*; and then (3) *radical change in economic policies* (Doyle and Hogan, 2006, p. 4).

Macroeconomic crisis needs little explanation for economists. However, Doyle and Hogan (writing in the Political Science journals) explain *macroeconomic crisis* at some length. In short, they specify that the following are the key elements of any macroeconomic crisis: Decade-long lows in key macroeconomic variables and widespread agreement within key sectors of the community about the existence of ongoing poor economic performance, viz. politicians, the mass media, and the general public. If these criteria are fulfilled, then the existence of a *macroeconomic crisis* is confirmed, according to Doyle and Hogan. Somewhat more complex, however, is the idea of *ideational change*.

Once an economic crisis has enabled a *generative cleavage*, policy choices need to be made, and this process will be decided by the "domestic political and *ideational* processes" (Golob, 2003, p. 375). Crisis opens a window of opportunity for new ideas, and one of them, among the many competing ideologies, becomes the preferred option and thereafter, the new ideas overthrow the prevailing paradigm (Doyle and Hogan, 2006, p. 13). The new paradigm (previously seen as radical) becomes the new *status quo,* and is speedily *assimilated* into policy[2]. As in Hogan's first sequential model (shown above), Doyle and Hogan's three-step

[2] *Assimilation* of another nation's ideas and concepts into their own economic policies is the last of the three key structural headings which constituted the analytical framework of transference (see Chapter 6, and 7 of this author's unpublished doctoral thesis: Heagney, 2009a).

framework is also considered to be sequential, and once again, all three steps need to occur (and in the order indicated) for the change event to be termed a *critical juncture*.

3. THEORETICAL DEVELOPMENT

For the purposes of this paper the discussion will continue on the basis of four assumptions. (1) The purpose of a fundamental tax reform is to assist in the reallocation of the economic resources of an economy. (2) A fundamental tax reform changes one or more of the following: the underlying principle of taxation; the balance of taxation; the tax base, and/or the instruments of taxation change. (3) The degree of change would dramatically alter the previously existing social contract[3]. (4) The fundamental tax reform of 1844 was guided by a process that can be termed the politics of tax[4]. (5) The 1844-45 politics of tax process directed the effective redistribution of the tax burden among the differing sectors and groups in the Crown Colony economy.

3. 1. Observation and Pattern Discernment

The politics of tax debate which decided tax incidence and resource allocation in 1844 New Zealand was fought over by the few who were willing and able to actively participate in the politics of the period (Leiberman, 2001a). The social behaviour of the polity's participants, recorded in previous study undertaken by this author, leads to the assertion that from the perspective of the historical narrative of that previous work, behavioural observations can be discerned from the fiscal events which occurred during study period, 1844-45. Those observations are commented on below.

The four hypothesised sequential stages in the political process, i.e. the observations, are as follows: (1) the undesirable outcomes of previous policy decisions give rise to a mandate for change; (2) an institutional change event occurs in the form of a new leader, and thereafter, an entirely new polity emerges; (3) from the foundational framework of a clearly articulated ideology the new ruling institution begins a strategic re-evaluation of existing economic policies which thereafter, are usually but not always, publicly debated to the point of change. Well recognised politically is the fact that, however much a policy change is debated, given the institutional construct of political decision making, opposition to a change can only modify the policy outcome and not radically alter it; (4) an emergency is usually necessary to bring about major changes in tax policy. In some circumstances however, it is enough simply to generate a feeling of urgency in the economy, without the reality of a real crisis existing. Thus, in simple terms, when these events do occur in sequence they do enable a fundamental tax reform.

Those observations have led to the recognition of a pattern, namely, there exists a staged development to the political process which engendered Fitzroy's fundamental tax reform.

[3] Therefore, a fundamental tax reform is unlike the peripheral tinkering of James (2002), and, in fact, bears a closer resemblance to the crisis explanation of Feldstein (1976) and Thorndike (2004).

[4] See Chapter 8, Subsection 8.2 of this author's unpublished doctoral thesis: Heagney (2009a).

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Thereafter, some tentative hypotheses emerge: first, the development process did appear to be highly dependent on its initial starting conditions, something this paper describes as macroeconomic crises; and second, the method is clearly a sequential four-step development process, something which thereafter, explains the periods identified critical juncture by way of titling it; Fitzroy's fundamental tax reform.

3. 2. Tentative Hypotheses Development

However, a fundamental tax reform is more than a small part of a critical juncture event. A fundamental tax reform is the means to achieve a paradigm change, and thereafter, to lock in place the changes wrought as a result of the critical juncture event. Furthermore, a fundamental tax reform does not happen as a result of crises. Fundamental tax reform occurs because of other events/needs and, recurrent crisis is then used as a pretext or reason for change.

The requirement for economic reform, of the magnitude of a *critical juncture*, is constructed on the basis of an a priori fiscal and social need. An *ideational* position is something which is known to exist prior to the reform occurring. Therefore, the need for change is assumed to be widely acknowledged as existing, among politicians, technocrats and, the mass media. Furthermore, the need for change is generally well accepted by the public (see Goldfinch and t'Hart, 2003). This formative period for *ideational change* usually persists for some time before a *generative cleavage* actually occurs. This state of early awareness and the acceptance of a need for change by multiple sectors within the economy is a point emphasised in Hogan (2006), and Doyle & Hogan (2006).

The explanation above implies that the promulgated idea[s] - and there may be more than one - for policy change already exist and the proponents of change simply need suitable economic conditions to prevail for that change to be initiated[5]. This idea is common in the critical junctures literature and also in the tax reform literature. For example, the windows of opportunity hypothesis of Peters (1991), testifies to this. The economic conditions which open a window of opportunity; something the critical juncture theory considers as necessary to determine a *generative cleavage*, in this paper, is termed the *consequence of needs*, and further, that need is based on the existence of Doyle and Hogan's *macroeconomic crises.*

The pre-existing knowledge base of the economy and interest groups are the foundation of *policy formation,* a vital constituent part of the overall *policy formulation method*. In essence, this concept is very similar to Doyle and Hogan's explanation of *ideational change*. Furthermore, both of these – the *consequence of needs*, and the foundation of the *policy formulation method* - are the basic necessities required to begin a fundamental tax reform. Thus, the fundamental tax reform process has a sensitive dependence on its initial starting conditions. Therefore, the argument is, that without the *consequence of needs*, Doyle and Hogan's *macroeconomic crisis* and the foundation of the *policy formulation method*; the

[5] See Chapter 8, Subsection 8.4 of this author's unpublished doctoral thesis: Heagney (2009a), for a discussion of the degree of predetermination which gave rise to The Ordinance and the fiscal reforms which occurred in 1844 New Zealand.

beginnings of Doyle and Hogan's *ideational Change* process, a fundamental tax reform cannot eventuate.

Thus far, the theoretical development is as follows: Adverse economic conditions such as, *macroeconomic crises,* establish a *consequence of needs*; further, the identified economic *need* is then connected, via the foundation of the *policy formulation method*, to an ideology. For example; in the present context, the Manchester School of economics and the conjoint ideology of free trade. However, a further step in the process is required and, it needs to be sequential. A change to the existing rules of the game must occur; something termed here, an *institutional change* event.

Thus, a *consequence of needs*, and the foundations of the *policy formulation method*, are given life by a third occasion, the *institutional change* event. This kind of a political combination permits the previously articulated alternative economic policy or policies to be brought in by the (elected) agent[s] of change. Thereafter, a fourth sequential event is required and it is a succession of crises – thus, *constant disequilibria*.

Recurring crises are needed to galvanize opinion among all economic interests groups, i.e. those opposed and those in agreement, in order to provide further support for any new paradigm (economic restructuring). The end point in this game is the implementation of the new economic paradigm. This, arguably, explains the process of how the need for a fundamental tax reform is arrived at and also of why a fundamental tax reform is implemented. In order to direct an economy and to control an economic organisation such as government, it would be necessary to control its fiscal heart, i.e. taxation policy.

4. THEORETICAL FRAMEWORK

The focus now turns to clearly detailing the structural elements of the conceptual model. The structural elements are the observations of the developed theoretical framework and the requirement is to detail them in a manner that is hopefully timeless (i.e. not simply contextualised in the events of 1844). The reason for doing so is that the developed model will need to be tested against other tax reform events in economic history to ascertain whether the conceptual model has sufficient enduring attributes to tentatively confirm its veracity and to enable the model to be considered, potentially, as having more general applicable and thus deserving of future research. The observations (structural elements of the model) will in their timeless forms hopefully, constitute the headings of a conceptual model to explain a fundamental tax reform.

4. 1. Translating Hypotheses into Structural Headings

The first observational hypothesis: A crisis may occur as a *consequence* (result) of some prevailing *need*. An example of *need* would be the coincidental occurrence, for example, of a balance of payments deficit and a budget deficit[6] (a concurrent internal and external deficit requiring policies to achieve balance in one or both). While these may precipitate the change process, they are assumed to only do so if they occur in conjunction with a second key element, viz. the observational hypothesis which is (2) *Institutional change.*

The *institutional change* process needs to be significant, something such as a change of government, which (in modern terms) ushers in a new cabinet and a new leader of government; and this is where the realised new concepts and ideas of policy are formed. Having clearly articulated the new economic concepts and ideas, and differentiated these ideas from the other available options, the general public provides the newly elected polity with a mandate for change following an electoral poll (the *institutional change* event). The newly constituted polity may, thereafter, be able to effectively direct and control economic policy to a large degree. However, this still may not be how policy is ultimately determined; the political status quo is not always that easily changed (Doyle and Hogan, 2006, p. 16, for example, refer to the status quo as armoured policies[7]). Further pressure may be required to accomplish complete *ideational* collapse. The assertion is, that any policy package which stems from and constitutes a *critical juncture* event, is decided in a manner which has given rise to the paper's the third observational hypothesis, viz. (3) the *policy formulation method*.

The *policy formulation method* is the ongoing process of *ideational change*, a logical extension of the necessary starting conditions. Following crises, there is usually a loud call for economic reform or economic restructuring[8]. Much of the groundwork for this phase of policy change, to repeat, is usually prepared well in advance and it does not contain any previously unknown or new ideas. In fact, widespread acceptance of the new economic ideas is evidenced by the *institutional change* event. Nonetheless, it is not unusual for the articulation of a need for a *critical juncture* level of change to be contained in a single ideological phrase such as free trade or market liberalisation (the free market), or even something as simple as the concept of freedom itself. What is important is the public understanding of the phrase or expression which, for some time prior to the change, has been loudly and fully articulated (for example, an electioneering slogan). The ideological expression may be, and quite often is, the only requirement necessary for normative economic opinion to gain widespread acceptance to counter open and reasoned economic debate.

[6] It is not, altogether implausible, that a the coincidental occurrence of a balance of payments surplus and a budget surplus would also initiate a similar *consequence of needs* and thereafter, begin a sequence of events that would be similar to those described above.

[7] See Doyle and Hogan (2006, p. 16). "Armoured policies represent policy continuity, whereby once policy has become institutionally imbedded; *policy making becomes possible only in terms of these ideas*" (Blyth, 2001, p. 4, in Doyle and Hogan, 2006, p. 16)

[8] "Restructuring is short hand for the radical changes to economic and administrative structures by most governments in the OECD over the [previous two decades]. It is not restructuring *per se* but restructuring in a specified direction. This direction can be summed up as: a move away from government control of the economy and towards greater reliance on competition and market solutions" (Mulgan, 1997, p. 1).

After *institutional change* has occurred, the *policy formulation* process has a final goal. In the present context that goal is the reallocation of economic resources, and a redistribution of the burden of taxation according to a newly constructed social contract. This last point, incident-shifting, and public acceptance of it, is fundamentally important to successfully achieving a *critical juncture* event. Changes in taxation are used to promote/support fiscal and social change and to lock economic reforms in place. Tax changes reflect the very real change that has occurred to the social contract, and which an *institutional change* has previously approved.

Fundamental tax reform however, is still not necessarily assured by the presence of economic crises, prior knowledge, *institutional change*, public opinion, or negotiation within the polity. Even when all of them occur together, and in sequence they can still be insufficient to engender a major fiscal change or social restructuring. For a fundamental economic reform to occur, the continuing existence, in the short-to-medium term, of pressing reasons which validate the need for these changes is required. In addition, those pressing reasons need to be constantly acknowledged by the citizenry.

Therefore, it is absolutely necessary that the polity makes liberal use of the interim, peripheral, and recurring economic events (crises) to reinforce and enable the decision making process between the two key temporal moments of (1), the initial starting point, and (2), the end point of the game! Thereafter, a fundamental tax policy change becomes a reality. For example, Evans, et al (1996, p. 1871) claim that the creation of a series of disequilibria helped to justify and accelerate the reform process in New Zealand during the 1980's. This process, the creation of a series of disequilibria, has given rise to a fourth observational hypothesis, viz. (4) *constant disequilibria.*

Recurring fiscal disequilibria can be represented by the presence of repeated financial crises or, in the present context, ongoing *macroeconomic crises*. When a nation's fiscal position is already viewed as poor and new economic crises continue to surface at regular intervals then, as was shown in Heagney (2009a), they provide the final impetus for change to tax policy. In many instances a perceived sense of emergency can often be enough to initiate the fundamental tax change. The latter, a fundamental tax reform, can then be seen as an expected outcome of the change process. In short, a proposal for fundamental tax reform becomes legislated policy after a further series of untoward fiscal events.

Thus, from the theory so developed, four structural elements have been identified and these will constitute the structural headings of the model. Those headings are: the *consequence of needs*; the *institutional change* event; the *policy formulation method*, and the existence of *constant disequilibria*. A strong logical framework is now given to the theory and attention can turn to a discussion of the model of fundamental tax reform.

5. THEORETICAL MODEL

In the context of Crown Colony New Zealand - a period in New Zealand history when macroeconomic variables were few and uncomplicated - economic crisis had these features: the colony was attempting to establish itself amid a world depression; the Administration had expenditure needs far greater than its domestic revenue would support[9] at that time and there was a high level of unserviceable public debt. In the colony's European settlements there was unemployment and, in Maori settlements, there was much underemployment. The colony also suffered from a lack of circulating medium and the ever present prospect of racial conflict.

The financial condition of the Administration by the end of 1843 reinforced the colony's dismal economic outlook. The economy (and its limited financial sector) was enduring constant domestic financial crises and labouring under the external constraint of the British Treasury (*British Parliamentary Papers,* 4: 167). Furthermore, many sections of Crown Colony New Zealand's population were dissatisfied with the colony's state of progress and with the constraints the Administration was imposing on their own personal progress. Many colonists (and Maori) were openly opposed to the Crown's influence in the affairs of the colony and, unhappy about the performance of its agent, the colony's Administration (Heagney, 2009a).

5. 1. Contextualising the Theory

First, the foundations of *ideational change* had existed in colonial New Zealand and in the Mother Country for some time prior to 1844 (Heagney, 2009). Second, the macroeconomic condition of colonial New Zealand in 1844 constituted a valid *consequence of needs* (Heagney, 2009). Third, the arrival of a new governor at the end of 1843, and the appointment of a reformed Legislative Council in early 1844 were the *institutional change* events which initiated the process of economic restructuring in the colony. Fourth, the ongoing *policy formulation method* – the *ideational* change process which occurs after the *institutional change* event - was extensively discussed in (Heagney, 2009). After enduring *constant disequilibria* (crises), Fitzroy, it is argued, leveraged these economic events in order to pass the *Property Rate Ordinance,* 1844.

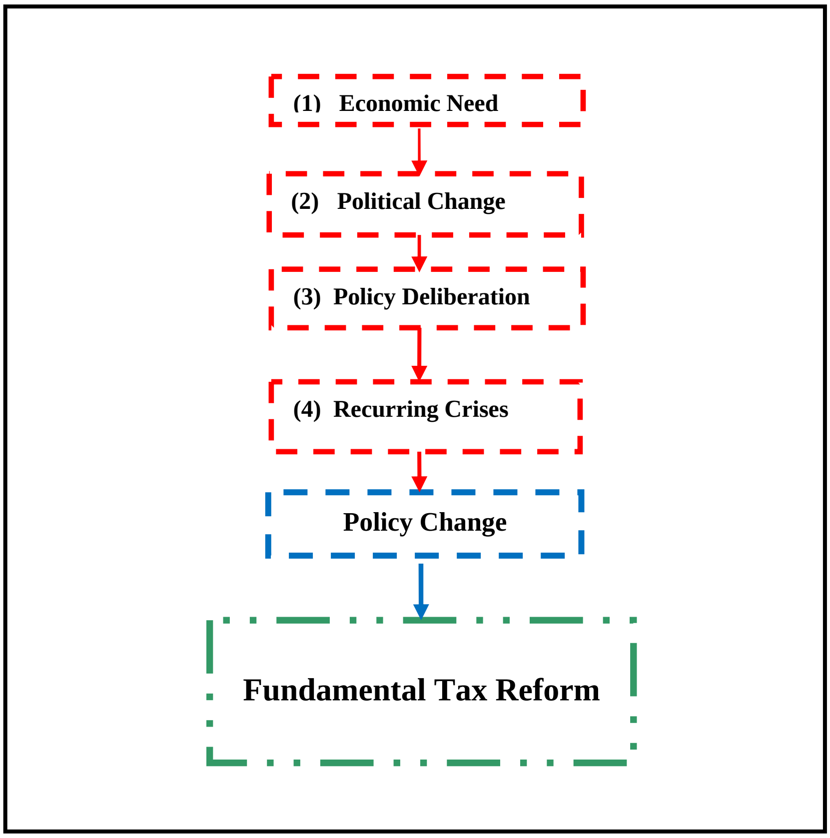
5. 2. The Model

Thus, from the four identified sequential events (1), the *consequence of needs*; (2), *institutional change*; (3), *policy formulation method*, and (4), *constant disequilibria*, a conceptual stage model is derived which explains the fundamental tax reform which occurred in 1844 New Zealand. The next step is to logically structure the headings of the Fundamental Model. This is achieved by first addressing the dynamics of the economic event that the model describes and secondly, by simplifying the headings. Thus, Economic Need, Political Change, Policy deliberation, Recurring Crises, and thereafter, Policy Change are the result. The final stage model, therefore, indicates that the fundamental model of tax reform is an interdependent - and for the purposes of this paper - is recognised as being a sequential

[9] See Heagney (2009) Discussion Paper 09-07.

economic process, and furthermore, a process that is highly dependent on its foundations: Primarily, its initial starting conditions. The model is summarised as a flow chart in Figure 1.1 below.

Figure 1.1
The Fundamental Model



In essence, the method of the Fundamental Model conforms to the critical juncture model of Doyle and Hogan (2006). (1) Economic need + (2) political change + (3) policy deliberation + (4) recurring crises equals policy change, viz. a fundamental tax reform. The staged process is has the chapter suggests seen as being sequential; all stages need to occur and, in the order indicated above, for the change event to be accurately termed a fundamental tax reform.

From one of the four assumptions of Subsection 3 the purpose of a fundamental tax reform is to assist in the reallocation of the economic resources of an economy. Thus, the existing economic status quo undergoes a process of reform. The end result is a structurally different economy with a new system of fiscal management that has at its centre a new tax system. This process is illustrated below in Figure 1.2.

Figure 1.2
Economic Reform

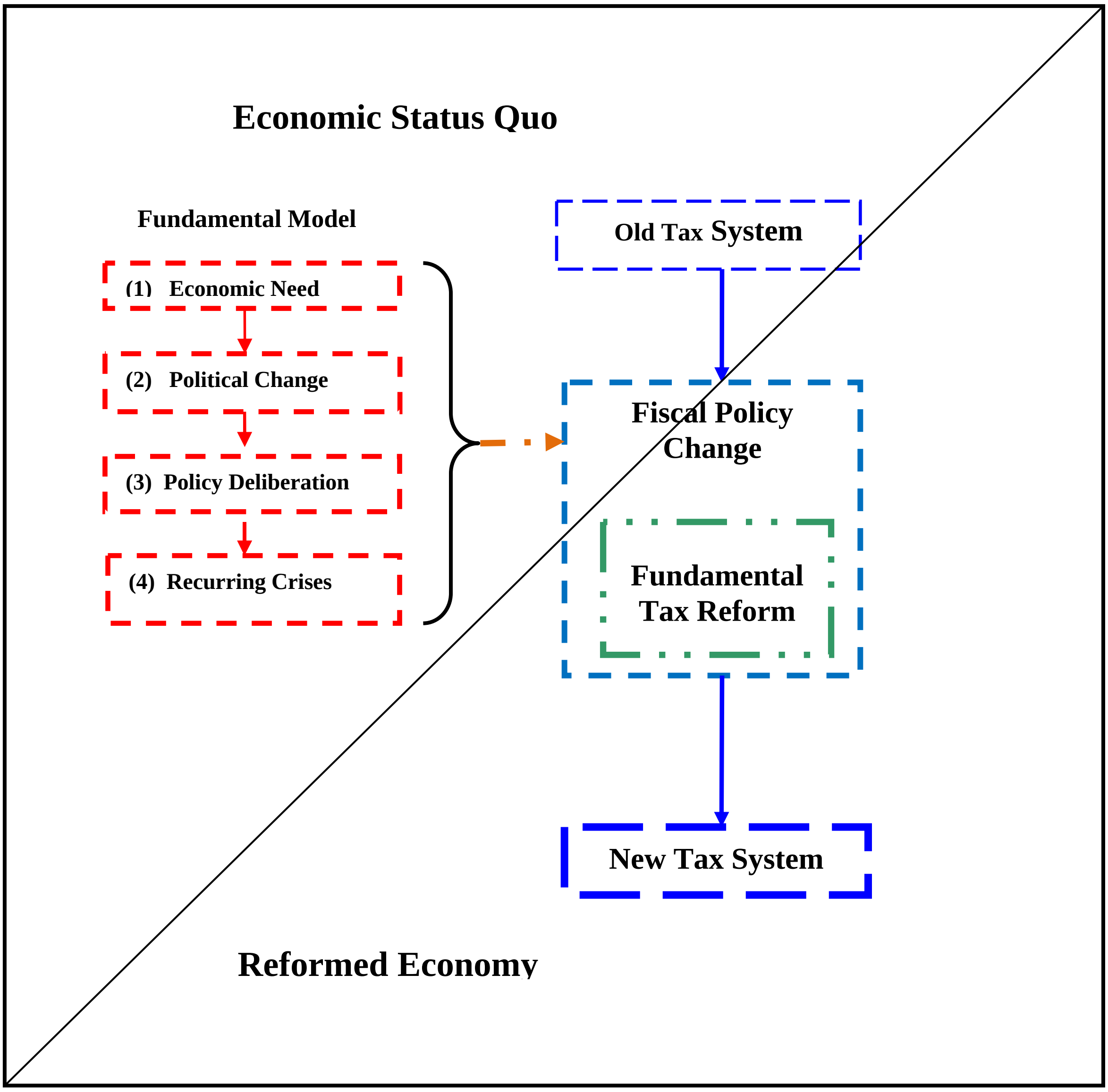


Figure 1.2 above, is an extremely simplified model of reality. However, the role that the fundamental model plays in the process of fiscal policy change is clearly shown. Also shown are the key relationships between the Fundamental model, fiscal policy change, tax reform and a reformed economy.

The presentation above of Figure 1.1 and Figure 1.2 brings to a close the theoretical analysis of Governor Fitzroy's tax reforms of 1844. Theory, however, is only the first step; the second is a graphical representation, and while both of these have being achieved, there is a third step to consider; a test of the derived model. Testing is undertaken by way of simple comparative analysis whereby, the model is assessed against another known tax reform in New Zealand economic history.

6. TESTING THE MODEL

There are limitations attached to the testing procedure undertaken within this Subsection of the paper. First, preliminary testing of a conceptual, stage model is not the focus of the work nor is it even a secondary objective. Second, the testing undertaken below is a simple comparative analysis of one other economic event only. Third, the simple test is the preliminary beginnings of any possible future research which may be undertaken in order to assess the model for validity and veracity. Nonetheless, a second New Zealand tax reform will now be used to serve an analytical purpose.

The tax reforms undertaken in New Zealand after 1984 have received much attention in New Zealand. Revenue reforms of this period (1985-86) consisted, in part, of a change to the philosophical basis of the tax system, viz. an extension of the tax base, a redirection of taxation (principally from direct tax to a more direct/indirect balance), and a reduction of rates of the existing direct taxes. Even these few aspects of tax policy change are substantive enough to have resulted in a very real redistribution of the burden of taxation and, arguably, a re-allocation of the economic resources within the New Zealand economy.

6. 1. A Consequence of Need

The economic condition of New Zealand in 1984 was the outcome of previous policy decisions and a crisis in the world's advanced economies. However, the economic condition of New Zealand in 1984 does constitute a legitimate *consequence of need*. A simple statistical record of the long-run performance of several economic indicators of the New Zealand economy is presented below.

Table 1.1
New Zealand's Macroeconomic Performance, 1956-95

	1956-65	1966-75	1976-85	1986-95
Growth in Real GDP (% of GDP)	4.2	3.8	1.6	1.5
Output Gap (% of GDP)	1.2	2.5	2.2	2.1
Unemployment (%)	0.1	0.2	2.4	9.1
Inflation (%)	2.8	6.7	13.4	6.7
Interest Rate (%)	5.3	7.2	13.4	14.2
Balance of Trade (% of GDP)	-0.4	-1.2	-2.5	1.1
Current Account Balance (% of GDP)	-1.9	-2.8	-5.6	-3.5
Misery Index	2.9	6.9	15.8	15.8

Source: Wooding (1997, p. 15)

From Table 1.1 above, it is apparent that from 1975 onwards to 1985, that real output growth has fallen. Real GDP growth, the measure of New Zealand living standards had halved by the nineteen-eighties. Unemployment had risen tenfold since the period of the 1950's; inflation had continued its steady increase and New Zealand borrowers were experiencing double digit (nominal) interest rates. The nation's current account balance continued to deteriorate and the overall misery index shows that economic conditions in New Zealand were, for many in the community, almost twice as difficult in the nineteen-eighties as they were in the nineteen-seventies.

New Zealand's credit rating had been downgraded on April 30, 1983, the year before the crucial election of early 1984; however, the exchange rate was still considered by many to be overvalued. Many sections of the community were dissatisfied with the state of the economy and the policy approach of previous governments. It is possible to say that, overall, many New Zealanders were unhappy about the government's imposed exchange restrictions, trade controls and the effect these were having on the economy.

On the fiscal front, there was much understandable annoyance with a tax system that promoted multiple economic inefficiencies; increased the deadweight loss associated with compliance, and maintained iniquitous redistribution. Furthermore, the existing tax system encouraged widespread market distortions many of which constrained and thwarted enterprise and, actively discouraged productivity growth. All of these negative externalities, attached to the tax system, were widely acknowledged as being detrimental to the long-term needs of the New Zealand economy and of its people. Therefore, constituents were openly opposed to the previous government's economic policy and, for some years, the main political opposition to government had articulated an alternative economic policy package - the foundations of the *policy formulation method* - for use when they would come to office.

6. 2. Institutional Change

The election of a new government and Prime Minister in 1984 was the *institutional change* event which initiated the process of economic restructuring. In addition, immediately after the 1984 election, a constitutional crisis developed in the interim between one government leaving office and the other taking over. This constitutional crisis was precipitated by the anticipated policy direction which the incoming government had clearly articulated to the public prior to the election: Reinforcement for the earlier arguments of pre critical juncture *ideational change* and the role this plays in laying the foundations for the *policy formulation*. Thereafter, as all relevant economic information was already known to many in the financial markets, it was hardly surprising that the financial markets acted, and consequently, there was a large capital outflow. This event was eventually countered with a devaluation of the exchange rate by the incoming government, even before they formally took office (Bishop, 2004, p. 20). The outcome of this (post *institutional change*), was a reinforced mandate for major economic change on the basis of a perceived continuation of another *consequence of need*. This occurrence was amply demonstrated to the public in the form of a constitutional crisis and an exchange crisis.

6. 3. Policy Formulation Method

From the framework of a clearly articulated ideology, in this instance "market liberalisation" (the free market), a series of strategic re-evaluations commenced, whether artificially or not, these moves were negotiated and debated[10]. Such negotiation and debate was artificial for the simple reason that the ideological capture of policy direction had already been achieved, and was subject to the control of the key personnel of the new polity. As indicated, the economic policies of the new polity were clearly enunciated prior to the election of 1984. Over an undefined period after the 1984 election, the *policy formulation method* and the subsequent direction for policy was accomplished by an elected executive (cabinet). While negotiation and debate are assumed to have occurred even within the new government itself, opposition to change was only able to modify policy at the margin, but not to radically alter it, once it was decided upon.

6. 4. Constant Disequilibria

The direction for economic policy after 1984 was clearly promulgated prior to the election and, the process of change was driven by a sense of emergency; in the earliest stages change was driven by economic and financial crisis. For example there were two runs on the New Zealand dollar (one immediately prior to the election of 1984 and another some months later as a response to policy change). Thereafter, urgency replaced emergency, and to avoid further occurrences of crises, previous events were used as the means to initiate major fiscal restructuring. Thus, *constant disequilibria* finally wrought change; the fundamental tax reforms were announced in the budget of 1985/86.

The descriptive analysis undertaken in this subsection of the paper amply portrays a much more recent fundamental tax reform in New Zealand economic history. The development process can be said to closely mirror the 1844 fundamental tax reform of Governor Fitzroy. Furthermore, though it is not mentioned above, just as Fitzroy had a reversal of circumstances - and a second fundamental tax reform eventuated - the tax reforms of the New Zealand Government, the post-1987 phase of economic development, also took a step too far, and consequently, also suffered a crisis-induced policy reversal. That story, however, is a matter for others to research.

[10] Australia had a Summit; an Accord with the trade unions, and a Tax Summit (Goldfinch and t'Hart, 2003). Similarly, in New Zealand there was a Summit and Tax Review undertaken (Easton, 1989). In similar fashion Ireland underwent similar policy negotiation and deliberation with trade unions in the 1980's. I comment here, that the process, in essence, describes a method of arriving at an understanding with opponents, whereupon negotiation (submissions), however hollow, take place and the passage of policy is assisted, not formulated.

7. CONCLUSION

The theoretical argument presented in this paper is a simple descriptive explanation of what was observed in the historical narrative (data) of the thesis. The observations, which came primarily from the previous work of Heagney (2009a), led to the recognition of a pattern to tax policy development. From the two initial inductive steps, observation and pattern discernment, it was possible to then suggest some tentative and explanatory, hypotheses. Those hypotheses were developed further by connecting to the substantial work of the *critical juncture* literature and to crisis theory. Thereafter, an extension to the existing theory on crisis-induced tax reform was proposed. The final conceptual stage model was illustrated in Figure 1.1 (above) and entitled, the Fundamental Model. Thus, abstract theory offered a plausible explanation for how Governor Fitzroy achieved his fundamental tax reform of 1844. Therefore, the chapter has met its stated objective which was the development of a theoretical model to explain the fundamental tax reform of Governor Fitzroy.

The theoretical analysis of this chapter has shown that the fundamental tax reform of Governor Fitzroy was not an effortless process; nor was it part of a continual process of incremental (and fiscally neutral) adaptation (something difficult to achieve in a colony as young as New Zealand was in 1844). A fundamental tax reform such as that undertaken by Governor Fitzroy in 1844 requires much knowledge, skill, planning, and public support (Goldfinch and t'Hart, 2003, p. 236). Furthermore, as analysis has shown, a fundamental tax reform also requires the untoward and usually coincidental occurrence of certain macro-economic events (the *consequence of needs).*

The occurrence of serious fiscal need was identified as both the initial starting point for Fitzroy's major reform and also the agent of change. The interim methods of *institutional change* and the *policy formulation method* were the means, and thereafter, *constant disequilibria* were the key to restructuring of the early New Zealand economy. This *critical juncture* approach to economic policy, essentially the creation of a new economic paradigm, is clearly displayed in the documented evidence of 1844.

The 1844 fundamental tax reform of Governor Fitzroy was the result of a structured and sequential process, and this is fully acknowledged in the paper's final model (Figure 1.1). Quite simply, the fundamental model shown in Figure 1.1 is understood by addressing the dynamics of that sequential process: economic need, political change, policy deliberation, and recurring crises. Combined with ideological purpose, this approach to policy change, in the context of 1844, has been seen to work. However, tax reform is not exclusive to 1844 New Zealand, and therefore, the paper's derived model, Governor Fitzroy's fundamental tax reform, was subjected to logical testing in another era, viz. the tax reforms which occurred in New Zealand in the nineteen-eighties.

The comparative analysis undertaken in this chapter has shown that the tax policy development process which explains the major New Zealand tax reforms of 1984-87, can be said to closely mirror the 1844 fundamental tax reform of Governor Fitzroy. Therefore, early results suggest that the abstract model developed here may also have the potential to explain other past New Zealand tax reforms. Furthermore, by implication, if a pattern can be discerned in past tax policy developments then, this simple fundamental model may also have implications for future tax policy development. How that might be achieved is as follows: (1), to enlighten policy analysts tasked with considering interim tax policy analysis and (2), to assist in the identification of possible *critical junctures* and thus, to predict opportunities for future fundamental changes to tax policy.That endeavour, anticipating future tax policy development, is an exciting policy implication however, it was not discussed in this paper and is could be a highly rewarding area for future research.

Finally, the question remains as to how the work of this paper fits in with the initial hypotheses. The introduction posited that the New Zealand tax reform of 1844 did provide the basis for a workable model of a fundamental tax reform. In short, the work has enabled the development of an abstract model to describe the tax policy development process of Governor Fitzroy in 1844 New Zealand. In response to the question posed at the start of this paragraph, findings are that events of 1844 do provide the necessary details to construct a simple model, and one that may have potential for further study. The analysis of this paper and the subsequent findings is a useful beginning for any derived model of a fundamental tax reform.

There is, however, a final matter of importance to comment on, and that is, the question posed in the paper's preface and, thereafter, indirectly addressed by the work's core analysis. Was any guiding principle apparent in the development of tax policy during the study period (1843-45)? There *was* a guiding principle determining the development of tax policy during the study period, and that principle related to the underlying fiscal argument of Crown Colony New Zealand. That argument is, as a result of the analytical methods applied in previous studies by the same author, Heagney (2009a), very apparent. The argument centred on a single question: Who was going to pay for the colonisation and economic progress of New Zealand? The likely options were: (1), New Zealand Maori; (2), the British government; (3), the settlers, or (4), all groups in combination. The answer that Fitzroy and Parliament received in 1845 made it quite plain that neither Maori nor the colony's early settlers were willing (or perhaps able) to pay and thus, if the colony was to succeed, the British taxpayer would need to underwrite the venture for many years into the future. Fitzroy's fiscal reforms, discussed in some measure in this paper, in my view, helped pave the way to sustaining a workable future for the colony.

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