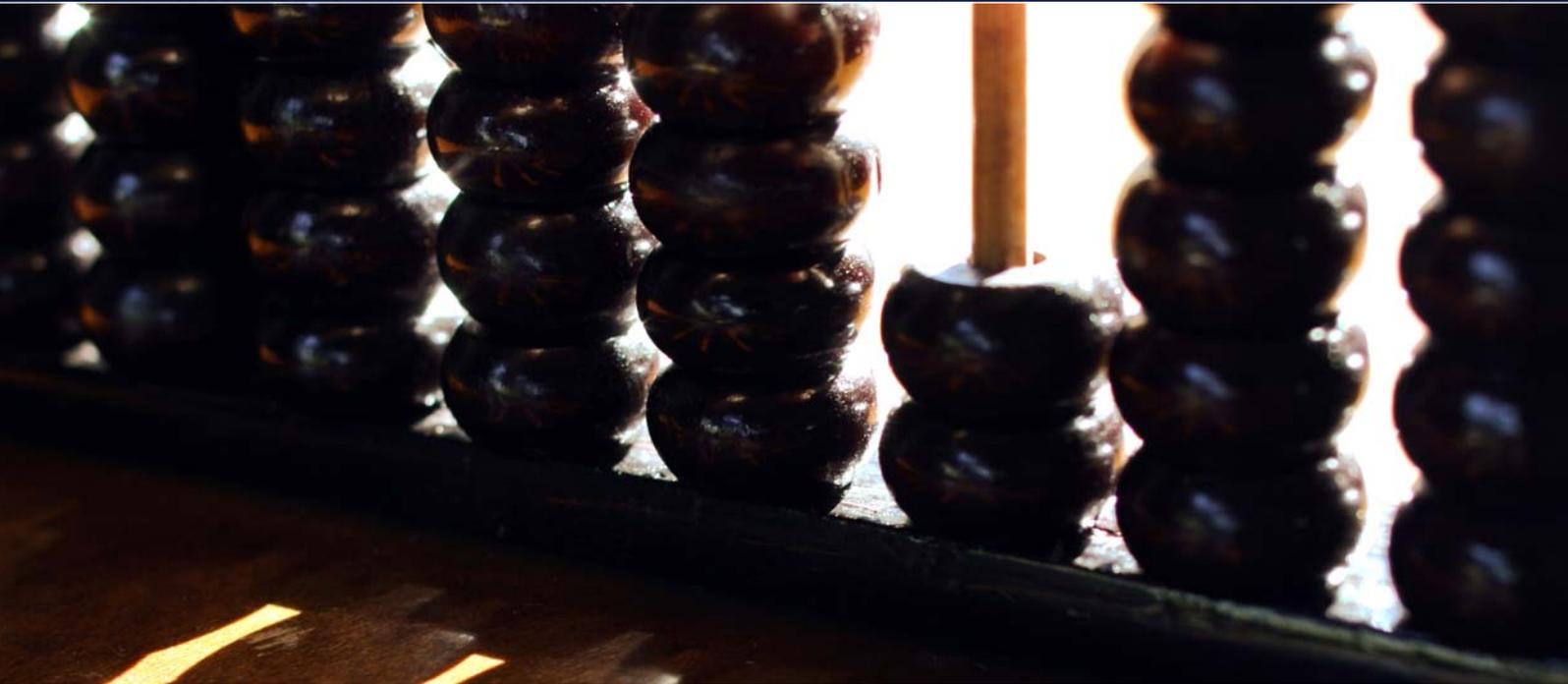




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SCHOOL OF ECONOMICS AND FINANCE

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KEVIN HEAGNEY

NEW ZEALAND'S FISCAL INHERITANCE
An Assessment of the Development of Direct
Taxation in the Mother Country Part II: 1701-1800

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NEW ZEALAND'S FISCAL INHERITANCE

An Assessment of the Development of Direct Taxation in the Mother Country

PART II

1701-1800

Kevin John Heagney¹
School of Economics and Finance
Massey University
Palmerston North
New Zealand

ABSTRACT

This paper is a critical review of the development of British taxation during the eighteenth century. According to the literature, when New Zealand was established in 1840, the country inherited the British tax system (Hooper, et al, 1998). To date, in the context of New Zealand fiscal history, there is a paucity of material which critically examines the contents of New Zealand's fiscal foundations, the evolution of Britain's tax system. This paper, the second in a series of four, finds for the eighteenth century, that the underlying principle of tax did change by centuries end, the tax base was enlarged, the principle method of taxation remained indirect yet at century's end a new direct tax initiative was begun; the income tax. In addition the politics of tax and economic thought i.e. ideology, played significant role in the development of tax policy. Finally, the driver of tax reform during the period was still crisis; first external and most importantly, internal financial crisis.

JEL: N, Economic History

Key Words: Eighteenth Century; Policy Development; English Heritage; Tax Law; Drivers of taxation; Economic History; Tax History; British Tax History

¹ Corresponding author. Email: K.Heagney@massey.ac.nz; Phone: (06) 3505799 Extn. 2658. I would also like to acknowledge the assistance of the following persons: Emeritus Professor Srikanta Chatterjee; Dr James Alvey and Dr Neil Campbell.

1. INTRODUCTION

The first paper in this series opened by stating that New Zealand began in 1840 as an Administered Crown Colony; a small part of the British Empire. Therein, Hooper et al (1998) described the European experience which, the first European 2,000 settlers brought with them, as our English heritage. However, the first paper did also mention that the evolutionary details of British taxation policy are not found in the New Zealand tax history literature, and the comment is repeated herein. Therefore, the question for this second paper is still to ask; what was the European experience of developing fiscal policy, and for the last two papers in particular, their experience of the evolving policy for income tax.

The purpose of this second paper, Part II in the series, and the two which follow², is to continue to fill a small part of implied gap in the literature (Hooper et al, 1998). To the best of my knowledge, no other New Zealand work has extensively considered any aspect of the fiscal methodology that is built into New Zealand's fiscal foundations. Therefore, this paper will build on the theme that was first discussed in Part I. The theme is derived from our understanding of McKinnon (2003, p. 11); the genius and evolution of New Zealand's fiscal (tax) policy is a product of the transference of ideas, concepts and the experience of applications in taxation from the Mother country. Thereafter, using the chronological narrative as a method, the paper will consider the development of the British tax system during the eighteenth century; detail the process of change, and attempt to identify the drivers of eighteenth century tax reform.

Once again, the paper acknowledges that a necessary requirement of scholarship is a statement of direction. Thus, the five tentative suggestions of the first paper become the hypotheses for Part II of this English Heritage series. First hypothesis, the key to understanding taxation lies in determining the period's principle of taxation. Second hypothesis, the balance of applied taxation regularly changes from indirect³ to direct⁴, and back again over time. Third hypothesis, throughout recorded history, crisis is the arbiter (driver) of change. Fourth hypothesis, economic thinking is a major influence on tax policy development. Fifth hypothesis, the politics of tax ultimately decides the final form any tax policy will take.

The paper is laid out in the following manner. Section 2 contains the methodology, method and data section. Section 3 introduces the period 1701-1800, and Section 4 is the analysis section. Section 5 is the papers discussion of the period's taxation policy, and section 6 considers the early eighteenth century beginnings of income tax. The conclusion is in Section 7.

² This discussion paper is the second of four which focus on the fiscal heritage of New Zealand. The series began with the years 1601-1700, and thereafter this second paper will focus attention on the first of two centuries where statistical data is available, 1701-1850. This will enable some qualitative assessments to be undertaken for the two periods in question. Finally, in the last paper, Part IV, the discussion specifically focuses on the nineteenth century's major development for direct taxation i.e. the income tax.

³ An indirect tax is one which is levied on goods and services; it becomes a burden on people only indirectly (Samuelson and Nordhaus, 1998, p. 441).

⁴ A direct tax is one which is imposed directly on an individual or firm (Samuelson and Nordhaus, 1998, p. 441).

2. METHODOLOGY

McKinnon (2003, p.11) comments on the centuries of English history, that which assisted in creating the New Zealand institution (The Treasury). Similarly, New Zealand taxation can be said to owe its heritage to the United Kingdom, and their many years of fiscal evolution. Alley, et al, (2004) inform us that these [very] early historical underpinnings are important to the current-day practice of taxation; a view also shared by Ames and Rapp (1977, p. 161). Therefore, as a working methodology – the understanding which guides the four studies in this series of discussion papers is a simple idea; the genius and evolution of New Zealand's fiscal (tax) policy is the product of the transference of ideas, concepts, and applications in taxation from the Mother country.

2.1 Method

The primary method of this long-run study is to separate the British experience of tax policy development into three periods. Part I, was a summary of the seventeenth century. Part II, is a review and quantitative assessment of the fiscal data of the eighteenth century, and Part III, the shorter period of 1801-50 will also be a review and quantitative assessment of that period. This latter paper is transformed into a one hundred year period by stretching the discussion to cover the years 1760-1860. Thus, Part III is similar to the periods which precede it and this approach makes comparative analysis possible. Part II and III will both consider, in some detail, the development however, Part IV will, in a review format, focus attention directly on the nineteenth century development of the British *Income Tax Act, 1842*. The end point for the study is 1850; New Zealand became self governing in 1853, and thereafter, tax policy was the responsibility of New Zealand's Parliament.

The subordinate method of this paper, and the two which follow, is the chronological narrative, something that is not unusual in tax history studies; thus, the work follows a research track that is well worn. The work of this paper is essentially a review of an important but limited body of scholarship. For example, the work of: Martin (1833); Dowell (1885); Kennedy (1913); Coffield, (1970); Matthias and O'Brien (1976); Sabine (1980); Hartwell (1981); O'Brien (1988); Beckett and Turner (1990); Adams (1993); Douglas (1999); Daunton (2001); Horstman (2003); and Kozub (2003). However, this second paper is not simply a summary of their work. This paper will utilise the available statistical data of the period and undertake a quantitative assessment of those factors which may potentially be behind the development tax policy in the eighteenth century.

2.2. Data

Selecting the appropriate statistics, and also deciding how they are to be used is, in my view, a common problem in the tax history literature. For example, there are as many existing statistical tables for the period 1701-1850 as there are studies. Some, such as Martin (1833), and Horstman (2003), use nominal values. Williamson, on the other hand, uses real values rather than nominal (Williamson, 1984). Sources are often similar between studies; for example, Mitchell and Deane (1962). However, some make use of Dowell, (1885); a seminal article on British tax history. To add to the confusion, when different studies use similar data sources, there can still be large differences in the datum values and Hartwell (1981) is an

example of this. Further, there are even studies that transform the data before presentation i.e. O'Brien (1988).

The data used in this study are taken from the statistical tables of Mitchell and Deane (1962); *An Abstract of British Historical Statistics*. Mitchell and Deane are the preferred option for most if not all studies in British economic history. However, in this paper, Table 3.1., is the anomaly; the data in Table 3.1., were obtained from Dickinson (1967) and represent nominal values. All other data series have been changed only once; from nominal to real values. The changed data is presented in the paper in the form of line graphs. Finally, a word of caution; the use of long-run historic data does require some qualification and there are several reasons for this.

For example, Mathias and O'Brien comment; "systematic quantitative studies, which seek to provide a comparative analysis of different national economies raise formidable conceptual, methodological and statistical problems" (Mathias and O'Brien, 1976, p. 601). Accordingly, simple inspection of the data used herein, reveals a disturbing similarity between all series. A relationship between variables is expected however, the pattern evident in some of the data does raise questions of a methodological nature. Nonetheless, an investigation of the construction of each variable is outside the scope of this paper. Therefore, the paper does not attempt too much with the numerical data. This completes the Methodology section of the paper; attention is now turned to the development of British tax policy during the eighteenth century.

3. THE EIGHTEENTH CENTURY

The period's main method of taxation was indirect, and the primary methodology of the period was the benefit principle (augmented by the ability to pay). Together, principle and method would be much influenced during the century by the development of political economy. 1701-1800 was a significant part of the enlightenment period, a time when Adam Smith for example, gave us his famous maxims of taxation⁵. Taxation and the business of public finance was, more so than today, an important facet of people's lives. Nonetheless, the reasons that gave rise to increased needs for fiscal revenue in the previous century were still consistent throughout the eighteenth and by the end of the century the forerunner of a method of direct taxation which today, in great part funds fiscal purpose in the developed world, came into existence; the Triple Assessment of 1798. In the sections that follow, this paper will consider the development of tax policy between the years 1701 and 1800.

3. 1. England: 1701 – 1800

The work begins with a link between the seventeenth and the eighteenth century. The following table (Table 3.1) conveniently joins the previous century to the period under discussion. The table considers the Crown's long-term borrowing position from 1693-1739, and also how that borrowing was funded. There are three points of note and these are commented on in the table below.

⁵ Smith's maxims of taxation were: *Equality in collection; certainty of collection; convenience of collection; economy in collection*. (Smith, 1776, pp. 777-778).

Table 3.1
Government Long-Term Borrowing & How Funded, 1693-1739 (Selected loans)

Date ^a	Amount	Interest %	How Funded
Jan 1693	£723,394	14	Additional Excise Taxes
Mar 1694	£1,000,000	14	Duties on Imports
Mar 1694	£1,200,000	8	Additional Customs and Duty
Apr 1697	£1,400,000	6.3	Excise and Duties
Jul 1698	£2,000,000	8	Additional Excise Duties
Mar 1707	£1,155,000	6.25	Surplus from funds of five loans from 1690's
Jul 1721	£500,000	5	Hereditary Revenue of the Crown
Mar 1728	£1,750,000	4	Coal Duties
May 1731	£800,000	3	Duties
Jun 1739	£300,000	3	Sinking Fund

^a Date of Royal Assent of Loan Act.

(Dickinson, 1967, Tables 2, 3 and 22).

From Table 3.1, above; in the early part of the century, taxation was used to underwrite fiscal borrowing. Also observable is the method of detailing specific revenue to an individual loan, and there is a change in methodology for the years 1707, 1721, and 1739 i.e. revenue was not mortgaged to debt. The identifiable variance in methodology post 1700 may imply that burden of taxation during those periods might not have been predicated by the need to fund debt. Further, the third column of the table indicates that the interest charge trends downwards over time. This may be explained by three factors; the development of financial budgets⁶, improved methods of accounting, and the financial innovations of 1694. The new style of fiscal management and the reason for that change are much commented on in the literature and there are several hypotheses to contemplate.

3. 2. Hypotheses for the century

“In broad terms, the figures available for the eighteenth century suggest that central governments of France and Britain used most of the revenue they acquired from taxes to support their respective military establishments and to pay interest on debt which had being incurred in large part also to enlarge their armies and navies in wartime” (Mathias and O’Brien, 1976, p. 602). Military expenditure was thought to have driven “a need to raise and maintain high levels of taxation during the century” (Douglas, 1999, p. 24). Beckett and Turner suggest that the expenditure needs of war had the effect “of imposing high and rising taxation” on the population (Beckett and Turner, 1990, p. 399). The latter author’s also comment; that “the overall rise in taxation was regressive” (Beckett and Turner 1990, p. 401).

⁶ The Government use of financial budgets begun sometime between 1688 and 1733, and was in common usage by 1750. Halsbury’s Laws of England Vol. 34 place the date for the start of the government use of financial budgets at 1688, whilst the former authors suggest the differing date (Douglas, 1999) and (Daunton, 2001).

Furthermore, Coffield comments that “inflation killed the revenue⁷” (Coffield, 1970, p. 67), and this led to “increasing rates and measures to maintain a balance”.

In addition to the above hypotheses it is worthwhile to comment that during the course of the century there other important factors to consider. First there was population growth⁸; second, there was economic progress; third, the principles of sound finance were still to be mastered; and four, the final resting place of incidence and the associated politics of tax were key questions in the mind of political economists. With the hypotheses of the literature in mind a quantitative assessment is conducted in the analysis section.

4. SUBJECTING THE CENTURY TO ANALYSIS

This section of the paper utilises the available statistical data to analysis the hypotheses of the literature. What follows is an attempt to qualify and better understand the evolutionary process of British tax policy development during the eighteenth century. Analysis begins below with an overview of the Crown’s fiscal performance.

4.1. Record of Fiscal Performance

The record of the Crown’s budgetary performance is illustrated below in Figure 4.1. The graphical display is a narrow view of fiscal performance, being a record only, of revenue minus expenditure. The data should not be considered in terms of current or capital accounts. Further, the financial records reflect the single entry cash approach to public finance accounts⁹.

Observable from Figure 4.1, above, are sixty one years of deficit and thirty nine years of surplus. The trend is negative and increasing in severity over time. The troughs do coincide with periods of conflict. For example, the war of Spanish Succession (1702), the war of Austrian Succession (1742), Seven years war (1755), American war of independence (1775) and war with France (1793). To highlight this, the military expenditure is overlaid below in Figure 4.2.

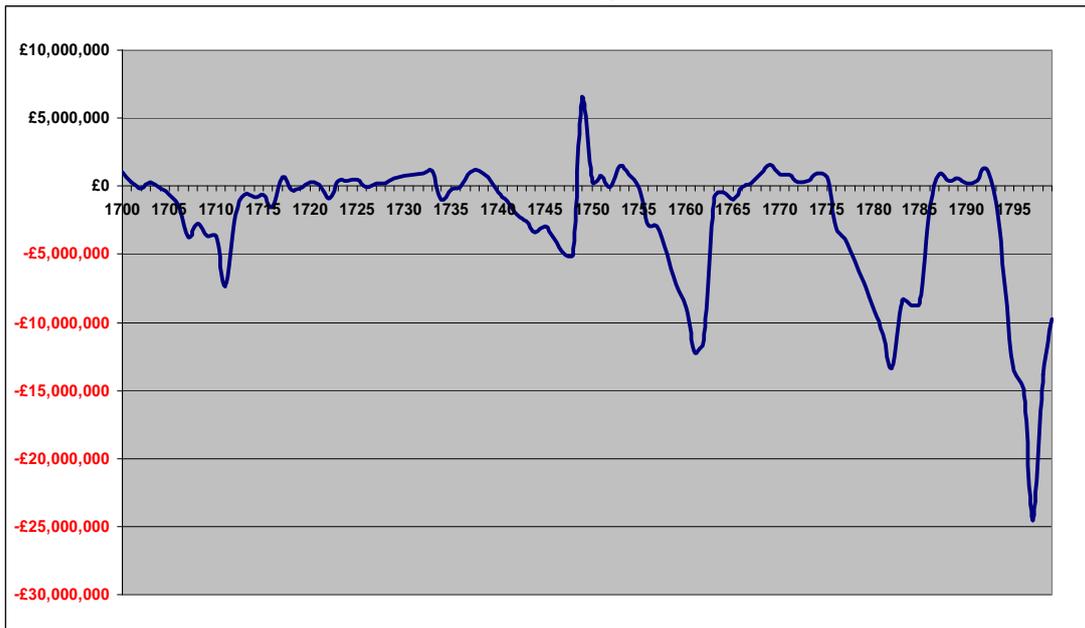
Clearly, in Figure 4.2, Military Expenditure mirrors the budget balance i.e. the costs associated with conflict explain the deficits. However, there is also another factor to consider. The literature also mentions that during the course of the century there were many financial crisis to contend with and Hoppitt (1986, p. 44-45) lists thirteenth such occurrences during the period. All but four periods of financial crisis coincide with periods of fiscal deficit, and Hoppitt tentatively links eleven of the thirteen to difficulties in the public finances.

⁷ The total amount, (value in nominal terms), of tax collected by the ruling authority are herein termed revenue.

⁸ Population growth is not extensively considered in this paper. The reason for this is that in Part III of this series there is an overlap between centuries and a discussion of population growth is considered to be more appropriate in that context.

⁹ A discussion paper in the School of Economics and Finance, Massey University contains a summary of the accounting methodology used in the compilation of public accounts and also of their method of construction (Heagney, 2009b).

Figure 4.1
The Government of Britain's Budget Balance: 1700 to 1799



(Mitchell and Deane, 1962, pp. 386–391).
 (Deflator; Mitchell and Deane, 1962, pp. 468–470)

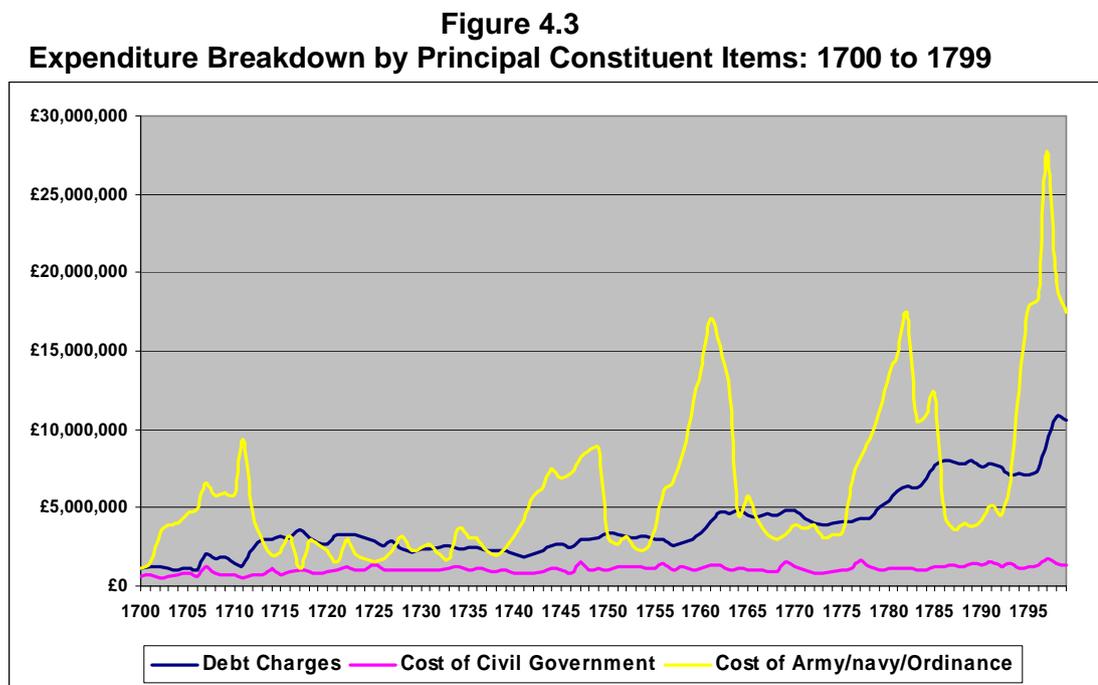
Figure 4.2
Military Expenditure of Britain
Compared with the Governments Budget Balance: 1700 to 1799



(Mitchell and Deane, 1962, pp. 386–391)

4. 2. Expenditure

The literature suggests that “in peacetime more than half of all expenditure went into paying interest on the national debt” (Beckett and Turner, 1990, p.398). To investigate this statement the disaggregated expenditure data are displayed below in Figure 4.3. The points of note, which derive from simple observation, are commented on below.



(Mitchell and Deane, 1962, pp. 386–391).

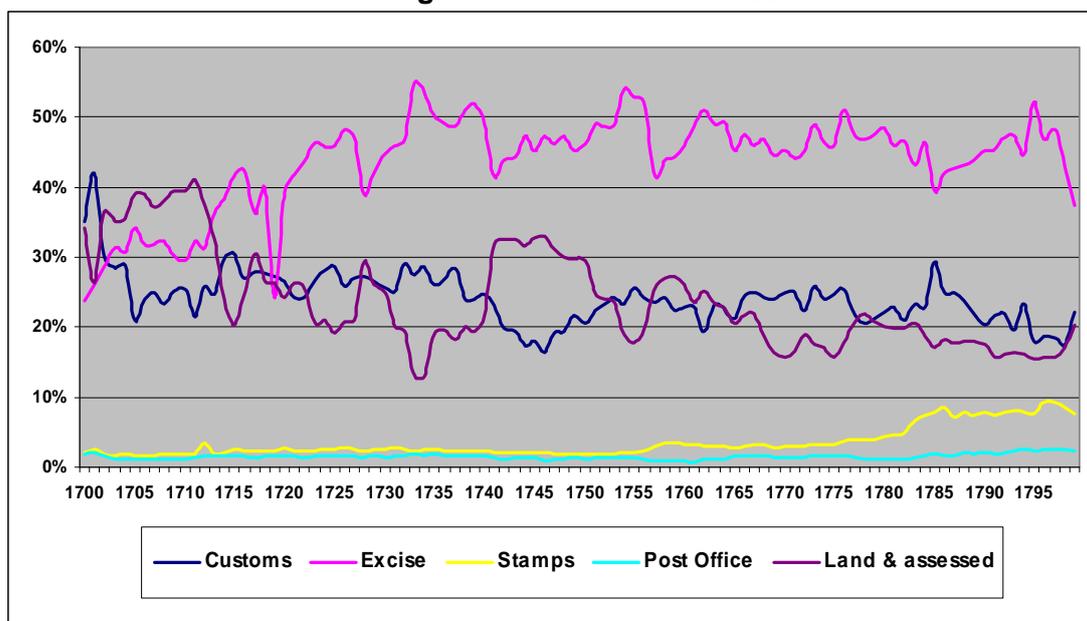
The Cost of Civil Government appears static during the period however, all three heads of expenditure in Figure 4.3, are positively sloped. Further analysis of the underlying data reveals that Civil Government expenditure averaged 3% growth over the century while Debt Charges grew at 9%. Military Expenditure grew disproportionately by comparison to Civil Government and Debt Charges; but, the extremes in the military budget make simple analysis less than useful. Therefore, the interesting point is the rise in Debt Charges over time. These charges do begin to decline during the second and third decade but rise again thereafter. Finally, Debt Charges are not seen to mirror Military Expenditure as seen in Figure 4.2.

Further to the above, it is worth noting that there were increases in Debt Charges subsequent to the fiscal crises of 1760, 1780, and 1797. What is not clear in the statistics is which had the greatest influence on the fiscal position, external crisis or internal crisis. Perhaps the dual coincidence can be seen as contributing factors toward financial necessity. In conclusion therefore, conflict (external crisis) is not seen as the single guiding factor of rising expenditure and thus rising taxation to meet that expenditure need. As a plausible explanation conflict (external crisis) needs to be considered in tandem with other relevant factors such as internal financial crisis.

4.3. Revenue

Figure 4.4, below, illustrates the major eighteenth century taxes and their performance over time. They were are the combination of direct and indirect taxes. Principally, Customs, Excise, Stamps, Post office and finally the Land and Assessed taxes.

Figure 4.4
Revenue Breakdown by Major Tax Types;
As a Percentage of Total Revenue: 1700 to 1799



(Mitchell and Deane, 1962, pp. 386-391)¹⁰.

From the above table (Table 4.4) the rise in Excise taxes began around 1711; at the same time Customs and Land taxes began to decline. 1711 was also the same year as the first major deficit, and the first major financial crisis of the eighteenth century. Nonetheless, Beckett and Turner (1990, p. 391), suggest that Excises exceeded Customs from 1680 onwards. While possible, Figure 4.4, does not show this. At the beginning of the century the Customs, Excises, Land and Assessed taxes, the bulk of the revenue, contribute 35, 24 and 34 percent respectively.

However, “from the 1730’s the [revenue from the] Excise was at or not far below 50% of total revenue” (Beckett and Turner, 1990, p. 391) and this is evident in Figure 4.4. Furthermore, also observable is that Post Office and Stamps play a far lesser role during the first half of the century with Stamps only undergoing a positive change post the industrial revolution. As the century progresses however, Excise taxes (indirect taxation) take greater responsibility and by century’s end the makeup is: Customs, Excises, Land and Assessed taxes; 22, 37 and 20 percent respectively, exclusive of income tax.

¹⁰ Compiled using Mitchell and Dean’s revenue by tax type series “Gross Public Income – Principal Constituent Items, pp. 386-391” and deflated with; the “Schumpeter-Gilboy: Consumer Goods price index, pp. 468-469” to give real revenue values by tax type (Mitchell and Deane, 1962, pp. 386-391).

Analysis therefore suggests that the total sum of indirect revenue to total revenue was unchanged at century's end, only the mix was different. In fact, in accordance with the findings of Beckett and Turner (1990), the real decrease was in Customs, and the Land and Assessed taxes. The increased percentage share from Excise taxes merely redressed the balance. This, arguably, is indicative of a change in the balance of taxation. The rise in Stamps, post 1750, reinforces the view that the balance of taxation changed over the course of the century.

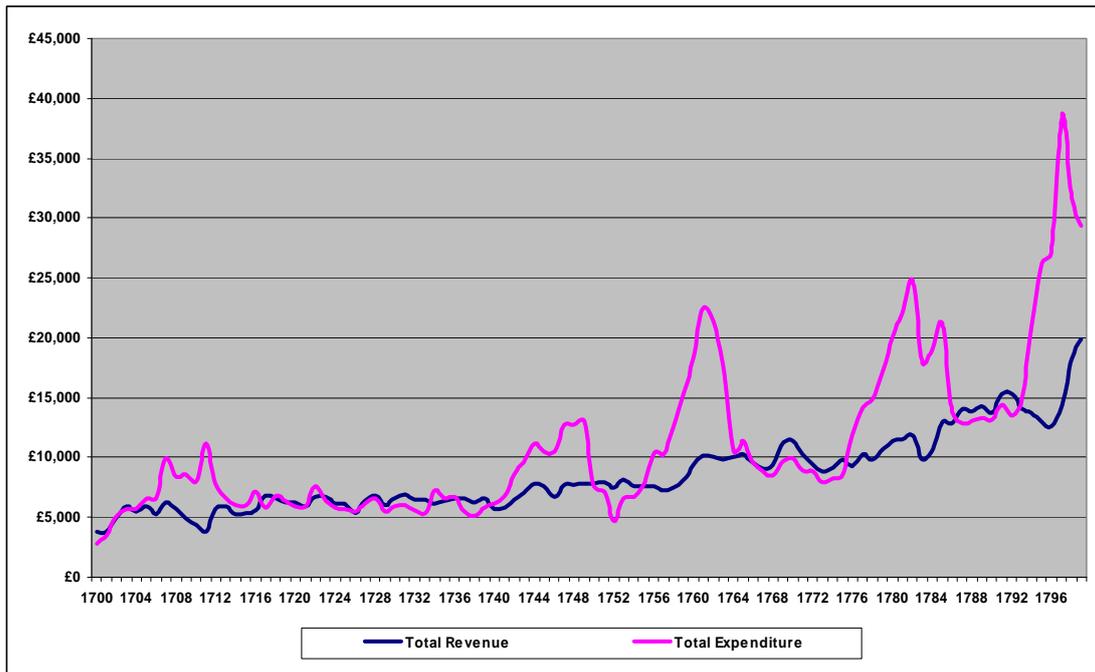
To suggest that the size and composition of the tax base had grown over time, due in a minor way to technological change and more so from Beckett and Turner's (1990) suggestion of population growth - might not hold. However, the idea that the interest groups who maintained the limited democracy did shift incidence may be quite plausible. Yet, Beckett and Turner (1990, p. 396) suggest that this is not the case, arguing that at the end of the century "the wealthier end of society bore the full burden of the new taxes". From Figure 4.4., the neutrality of the tax system appears to have been maintained, but at a cost. The burden shifted from those with land and property onto all persons in society via Excise taxes. Were taxes high? For some sectors of society the answer is yes, for others quite probably, no.

4. 4. Revenue and Expenditure

In respect of the revenue and expenditure combined; it is not a question herein of whether a sufficient revenue was raised. Nor of whether the "government refused to alter rates to protect the poor, or that sufficient finance was available without raising taxes" (Beckett and Turner, 1990, p. 392). On the basis of simple data analysis, that statement cannot be conclusively proven. All that can be asked of the data is; what does the record tell us about the progress of the revenue and expenditure during the period?

The information is displayed below in Figure 4.5. The graphical display illustrates the record of real revenue and real expenditure between 1701 and 1800. The assessment begins with the revenue; in real terms was it declining or was it increasing?

Figure 4.5
Revenue and Expenditure: 1700 to 1799



(Mitchell and Deane, 1962, pp. 386-391).

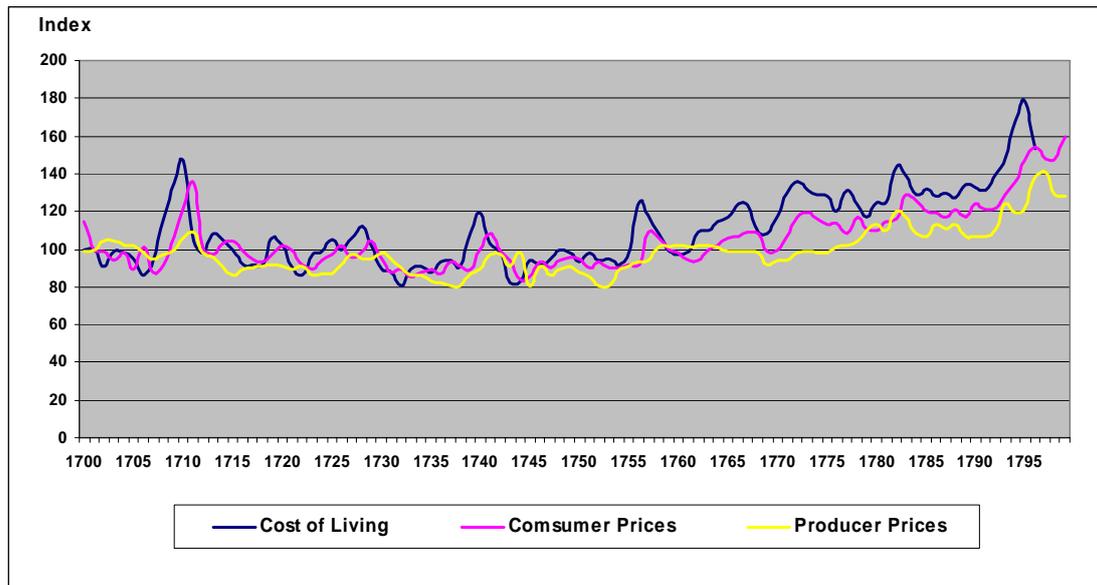
Matthias and O’Brien stated that “in constant prices, tax revenue was broadly stable on trend until 1740, - in aggregate terms” (Mathias and O’Brien, 1976, p. 606). This can be agreed with, but, closer examination of the disaggregated real values of Figure 4.5, does tell a slightly different story. Regardless, from observing the above graph, clearly revenue was increasing, and with an average over the course of the century of 2.2% growth in real revenue.

For expenditure, the pattern overall is also positive. Growth in expenditure averaged 4% over the entire century. Thus, expenditure had grown at twice the rate of revenue, but expenditure is marked by five extreme events and this contributes to the overall value. Furthermore, revenue did not increase in line with expenditure, indicating that expenditure needs were met by recourse to means other than tax revenue. Therefore, increasing revenue was not solely predicated by the requirements of expenditure. Given the role of individuals and firms in the makeup of the total revenue collected means that it is possible that once again other factors may have constrained taxpayer’s ability and willingness to pay taxes; for example, inflation.

4. 5. Prices

According to Coffield (1970, p. 67), during the eighteenth century, “inflation killed the revenue”. Inflation therefore, is responsible for ‘increasing [tax] rates and measures to maintain a balance’ Coffield (1970, p. 67). The record of economic performance during the period, illustrated using a cost of living index and two price indices is found below as Figure 4.6.

Figure 4.6
Great Britain's Cost of Living, Consumers' Goods & Producers' Goods Indices:
1700 to 1799



(Prices: Mitchell and Deane, 1962, pp. 468-469).
 (Cost of Living: Mitchell and Deane, 1962, pp. 346-347).

There are consistent, short bursts of inflation and deflation marking the century's progress. This can be divided into two distinct periods; prior to 1750 and post 1750. Further analysis of the data which constructed Figure 4.6, above, indicates that prices nearly double by the end of the eighteenth century¹¹. In terms of purchasing power, the equivalent sum of money in 1800 prices, of a £1 in 1750 was, £2 12s 9d. Unless matched by the increasing productivity of the economy, leading to higher real wages for workers, then real purchasing power would have declined. There is also a clear upward trend in the selected cost of living index after 1750. Inflation may well have been damaging more than the revenue.

From an inspection of Figure 4.6., above, the tax base may well have been realising a real decline in their purchasing power as the cost of living began to rise. The Producer Price Index of Figure 4.6, follows the same trend upwards, but there is a lagged response. It is quite possible that series compilation contributes to the lagged effect. However, the lagged effect may also suggest a difficulty in passing on those indirect taxes and give support to commercial claims that the application of indirect taxation led to reluctant and inevitable price increases which in turn depressed the economy. A closer look at the purchasing power of taxpayers and the cost of living may shed light on this matter.

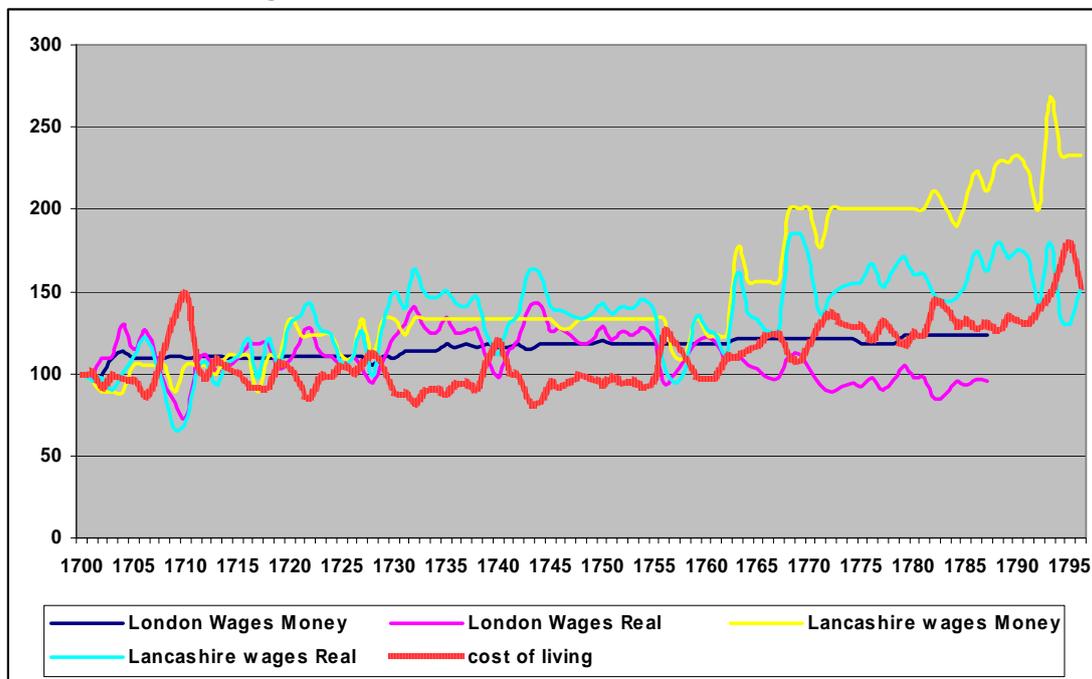
4. 6. *Purchasing Power and the Cost of Living*

Contrast the price indices of Figure 4.6, with that of Figure 4.7 below, in which two specific wage indexes for the period are displayed: the indices of Wages of Labourers in London & Lancashire. Important to note that when looking at the graph (Figure 4.7), that

¹¹ The index provided has also been used for the purchasing power example (O'Donoghue, Goulding and Allen, 2004, p. 40).

industrialisation did not occur until the latter half of the century and this reallocated numbers of the workforce into the industrial and commercial sectors.

Figure 4.7
Indices of Wages of Labourers in London & Lancashire: 1700 to 1799



(Wages: Mitchell and Deane, 1962, pp. 346–347).
 (Cost of Living: Mitchell and Deane, 1962, pp. 346–347).

The change post industrialisation is most notable in Figure 4.7, above; nonetheless, wages generally are considered to have been extremely volatile prior to 1800 (Clark, 2003, p. 2). The divergence post 1760 of the Lancashire index from that of London is explained by understanding that Lancashire was one of the earliest to move from its agrarian base and to industrialise. The real wages of Lancashire workers had increased 13% but their London colleagues had experienced a 26% fall in real purchasing power by 1796.

The Cost of Living Index and the Consumer/Producer Price Index, seen earlier in Figure 4.6., both increased significantly post 1760. While this may be attributed to the makeup of the indexes it can still be taken as being indicative of trends in the economy. “Undeniably the last 50 years of the century witnessed economic growth” (Hartwell, 1981, p. 136, Table. 2), but in some of the geographical and demographic sectors of the economy which also bore the incidence of taxation, there was less equivalence.

With an agrarian economic base that was slowly, and in parts only, becoming increasingly industrialized, the increase in the cost of living would have made many taxpayers worse off. Not surprising that the initial tax reforms of 1797, which simply increased rates or extended duty to more goods, did not significantly increase tax revenue.

4.7. Summary of Section 4

To summarise the section; analysis has found the following. Recurrent deficits, in response to spikes in Military Expenditure and numerous financial crises, meant that government expenditure was constantly rising throughout the century. Furthermore, the spikes in Debt Charges during the century were also linked to periods of financial crisis. Overall, real expenditure grew at a rate of 4% during the eighteenth century.

For revenue, Excise taxes underwent successive rate increases during the period in response to the recurrent deficits, and the financial crises. However, while the balance of taxation changed during the course of the century, neutrality was maintained. Yes, tax revenue increased; a 2.2% real increase over the course of the century. However, this was the result of population growth, industrialisation, and an increasingly concentrated population that was subject to, an unavoidable and regressive indirect tax system.

There was also much volatility in the general level of prices with inflation an increasing trend during the century. There was however, a steady rise in real wages yet, real purchasing power was also declining as the cost of living rose. Therefore, irrespective of population growth, industrialisation, or a concentration of taxpayers, the 2.2% real revenue growth and the 1797 tax reforms, which simply increased rates or extended duty to more goods, would not significantly increase tax revenue sufficient to match the 4% real growth in expenditure. Thus, new taxes (preferably direct measures) would need to be developed and a closer look at the century's politics of tax may shed some light on this process.

5. DISCUSSION SECTION

Understanding the process of tax policy development is a complex task and as Peters (1991) informs us, there are many issues to focus on; politics, economics, ethics, and administration. Peters (1991) further comments that “when talking about tax policy politics is trumps; nothing else will carry much weight unless government is willing to accept [tax policy proposals] and to enact [those policies] into law through the political process” (Peters, 1991, p. 3). Thus, any tax initiative, either a single tax law or a body of tax laws (tax system) is constructed subject to a politics of tax process. The politics of tax process is contextualised below in the eighteenth century.

5.1. Political Methodology

Taxation reform during the seventeenth century had supposedly centred on a singular premise: “That a man's total expenditure was a more equitable test of tax ability than income or wealth” (Hartwell, 1981, pp.142-143). This meant that the benefit principle ruled the day; the policy counterpart was indirect taxation. This philosophical approach continued throughout the eighteenth century, yet the body politic still sought to increase the revenue on this limited tax base. Expenditure, and thereby consumption, was the index, and this dictated that the type of taxation used, indirect taxes.

Any increase in the revenue thereafter, would be determined by an increase in the indirect tax base and the consequent final distribution of the indirect tax burden. The new indirect

taxation imposed by the Crown during this period, intended to impact upon the previously exempted lower classes, the merchants, and the industrialists. This extension to the tax base was to be achieved by increasing the number of goods subject to Customs duties and by making extensive use of Excises and Charges (the latter - Charges - are more commonly understood as being direct taxation).

Hartwell (1981, pp. 144-146) argues that the increased dependence on, and use of, indirect taxes during the century arose because these taxes were easy to collect and supplied predictable revenue yields. Hartwell's comments imply that this is an adequate explanation for successive governments continuing to rely on indirect taxation for raising revenue. A second suggestion comes from Boldrin et al (2005, p. 1). They refer to population growth and the subsequent economic growth, which led to a more dependent population. Dependence refers to a shift of the population from the rural areas to larger towns and cities, places where the population was more concentrated, and consequently, were more exposed to indirect taxation. These two theories, in combination, quite logically explain the increasing revenue trends associated with the period's maintenance of an indirect tax system¹². In any event, given the Crown's increasing expenditure, further revenue would need to be found.

The British tax history literature informs us of how revenue was raised during the eighteenth-century, and apparently the means mattered little to policy makers. Whether direct or indirect tax measures were used to raise that revenue was not a primary focus. The interest of the English government during the eighteenth century centred on the capacity of the population to pay (to bear the burden of taxation), rather than on any apparent ability to pay (Kennedy, 1913, Chapter. 5, in Hartwell, 1981, p. 151). Governments were focused on raising revenue in a manner that did the least harm to the economy and the interests of the political elite. "As long as the taxes were used to finance the public good [i.e. defence requirements], then the complaints of those represented in Parliament and those who were not [which was most of the population], were muted" (Smart, 1910, p. 37, in Hartwell. 1981, p. 148). This last comment appears in stark contrast to the view that Parliament during the period served the interests of the few. However, this depends rather crucially on one's definition of the public good and the underlying principle of taxation applied at the time. The principle of taxation is discussed further below.

As early as 1727 however, taxation would be aimed at achieving the theoretical premise of the benefit principle, sparing the land, but not the poor. The politically powerful of the eighteenth century adhered to the philosophy that "all persons should pay taxes [in other words, the benefit principle]" (Hartwell, 1981, p. 147). Since everyone shared in the legal protection and services provided by the state and, since government provided internal stability and national defence (and not much else), it could be argued that all benefited equally (Musgrave and Musgrave, 1980, in Kozub, 2003). Any burden (of taxation), should therefore be proportional to an individual's circumstances and condition of life.

¹² As an aside, in 1845 Governor Fitzroy would use the concentration hypothesis (Boldrin et al, 2005) as a justification for moving from direct back to indirect means of taxation in New Zealand (Fitzroy, 1846).

The important and determining caveat that went with this eighteenth-century attitude was that expenditure and consumption were to be the index for taxation, not income or capital. By 1780, an accepted beginning of the industrial revolution (Kozub, 2003, p. 363), this political strategy would come under pressure from cumulative and increasing war costs (including Debt Charges) and successive financial crises (Kozub, 2003, p. 371-379). Thereafter, economic necessity is credited with influencing political interests and this led to a redirecting of fiscal applications, namely the imposition of new taxes.

5. 2. *Toward a New Philosophy*

Tax reform; or more to the point, proposing major tax changes at the end of the eighteenth century would mean renegotiating the social contract¹³ but this time with the growing interest groups of commerce and industry. Landed interests and old money would see them as a new source of revenue; impositions on this group would rescue them from the need to pay more. At the same time the commercial and industrial sectors themselves would negotiate for tax reductions. They saw themselves as the most productive sector of society. Clearly, there was a tension between the appropriations of these groups. Each side would lobby to shift the tax burden elsewhere.

In addition, governments would have to consider the collective consequences of the industrial revolution. While the industrial revolution had produced economic growth, the benefits of that growth had not been distributed evenly among the community and many had suffered. Several factors had led to the shift of rural dwellers to urban locations. First, there had been substantial population growth, mentioned in the previous subsection. Second, there had been changes to agrarian practices which would require fewer personnel to work the farms. Third, there had been industrialisation itself. The consequences of industrialisation, however, were often social iniquity and infrastructural failure¹⁴.

The impact on the social contract would, according to Plehn (1902), be felt via the development of (a more effective system of) constitutionalism¹⁵; this issue, constitutionalism,

¹³ The key consideration is that the constitution of English society was on the basis of a handing over of rights to government and in return they would protect their interests and some of their rights. With respect to taxation; in my view, the current epoch of English civilisation was initiated in 1086 by the Domesday Book; a significant turning point and a tax document. From the Magna Charta to the Reform Acts of 1832 onwards the constitution has undergone major alterations but the basics premise remains. These thoughts are based on the ideas of Rousseau (1762).

¹⁴ “Many of the traditional modes of life were destroyed or changed beyond recognition. For some, life became better, for others it became worse....The inevitable urban growth brought with it crowded conditions, pollution, disease, crime and a host of other ills” (Canterbery, 2001, p. 68). The prevalence of the many social problems of the period is universally recognised by historians.

¹⁵ “The trend of the development of taxation was abruptly changed by the industrial revolution at the close of [the eighteenth] century. On the one hand, the vesting of constitutionalism, vesting as it did, the control of the purse in the people, and especially in the taxpayers, had the inevitable effect of changing the ideas underlying the tax systems. New ideas as to the justification of taxation developed and with them came a tendency to seek new measures of taxation. On the other hand, the rapid increase in wealth, the growth of new forms of wealth, such as invested capital, the birth of new kinds of property, as the many kinds of credits, and the rapid change in the distribution of wealth among the different classes in the community, - all of these and other similar causes led to the constant extension of taxation to the new forms. Old taxes which were well suited to certain simpler conditions of society become under new conditions unjust, and give rise to dissatisfaction with the many attempted and some accomplished reforms. The [reforms would prove to be] no more satisfactory in the long-run as conditions changed again” (Plehn, 1902, pp 144 – 146).

would further mature in the next century. For fiscal policy makers these multiple realities of social and political change would lead them to consider another important matter. Those persons and entities who had, and would, increasingly become caught up in the expanded tax base (individuals, commercial and industrial groups), in future, would begin to take more interest in the method of taxation, and in how taxation would affect their interests.

Nevertheless, in the interim, at least until the 1790's, successive governments could afford to ignore those without political power. On the other hand, they avoided political conflict with at least the principal actors in the social contract (remembering that until the twentieth century this was a minority group). This favourable approach to minority interest groups became steadily more fragile as the system of Public Debt (that had traditionally maintained the government) was increasingly seen as undermining the minority's economic stability. As a result of rising Public Debt, rather than interest group activity, new views on what was the fiscally optimal approach to raising revenue would begin to emerge.

It was however, a new crisis; renewed war with France would force the issue of fiscal change. The difficulty of funding the renewed conflict was the issue which compounded the (debt) problem and finally decided the matter. The difficulties of how to fund the war with France, and the other financial problems of government, were clear to those who decided fiscal policy. Less clear however, was how to raise sufficient revenue to meet these financial needs.

The first problem was that one potential revenue source, the commercial interests (see above), were already burdened. They were opposed to further increases in taxation. The other and more important factor was that the Bank of England had introduced a specie-backed paper currency. The introduction of paper currency was to counter the loss of bullion from the country to service the growing burden of war loans (Ebeling, 1999)¹⁶. This move (by the unofficial reserve bank) reinforced the effect of the earlier loose monetary and banking policies of successive eighteenth-century governments and accelerated a process that is unemotionally explained by the term, fiscal and economic stress.

With the benefit of hindsight, a strong argument can be made for loose monetary policy of the period being far more important to the story of financial crisis than some commentators have suggested. Could the use of funded debt, and the Crown's interdependent relationship with the emerging financial sector be more important than military expenditure as the driver of tax policy? It may be that the system of fiscal management used up to the late 1700's (primarily, indirect taxes and funded debt), was, at the very least, a contributing factor to the economic stress of 1797. A suggestion of this paper is that the problem was, quite possibly, applied monetary policy.

¹⁶ In Great Britain an important lesson had been learned as a result of the British government's financing of the war against Napoleon. Once the war with France began in the 1790s, the British government saw its military expenses rise dramatically. The government had what would be called today a line of credit that enabled it to pay its expenses with bills that the Bank of England was expected to redeem on demand in gold. But by 1797, the bank was faced with such heavy demands for gold redemption from claimants, both domestic and foreign, that its gold reserves were reaching dangerously low levels. The British government passed the Bank Restriction Act, which freed the Bank of England from having to redeem its bank notes and other financial claims in gold. When the Restriction Act was passed, the Bank's notes in circulation had a face value of £9.7 million on gold reserves of £1.1 million (Ebeling, 1999).

Even though there was much discussion of money in political economy circles the politicians often ignored theoretical developments¹⁷. This was a period of much experimentation in the field of financial intermediation¹⁸ and experimentation in tandem with loose financial oversight, led to multiple crises in the eighteenth century and this accelerated inflation. Prices did not stabilise until the early nineteenth century and the governments of the period do appear to be implicated in this perseverance of inflation¹⁹.

As a result of inflation, the revenue during the century may have responded in a similar fashion to the previous century, a period when inflation reportedly undermined the public revenue. If this undermining of the revenue did occur, a real decline in the revenue would also have increased public deficits and reinforced the reality of financial crisis. The reality of financial necessity at the end of the eighteenth century was widely acknowledged by the political actors of the day and by the influential political economists of the period (Horstman, 2003). The political initiative undertaken to meet the burgeoning financial need included the reappraisal of direct taxation and ultimately its resurgence as a means of increasing the revenue. New direct tax measures would only be an adjunct to the existing system of taxation but, direct taxation initiatives very clearly represented a broadening of the tax base.

The proposal which surfaced, the Triple Assessment²⁰, would form the foundation for the future direct taxation of incomes throughout the civilised world.

6. DIRECT TAXATION

Direct taxation is, in the context of this series of papers, concerned with the rise of income tax policy. The income tax laws of today originated in the British Parliament of 1797 and first became law in 1798. The story of this new addition to direct taxation begins below.

¹⁷ This last opinion is highly debatable, many would argue that the quantity theory of money (what is the basis of modern monetarism), was well understood during the period. The quantity theory of money came from the ideas of men like Copernicus (1473-1543), Jean Bodin (1530-1596) and others, all of these thinkers had an influence on David Hume's "Of Interest" in 1752. By 1797 the theory was clearly enunciated by Walter Boyd (1754-1837) and "the connection of money quantity to commodity prices and prices in general were a longstanding debate during the eighteenth and nineteenth century" (Hollander, 1910-11, pp. 429-470). Further, throughout the eighteenth century, the quantity of money, and the result when there was too much in circulation were keystone debates of political economy and the intermediation sector was much discussed

¹⁸ The reader is referred to an interesting book and this footnote provides a fairly complete reference because it assists in explaining the above statements. Anonymous. (1833). *History of the Rise, Progress, and Present State of Banking In All Parts Of The World; In Which Is Developed An Entirely New principle of Circulating Medium, For The United Kingdom of Great Britain & Ireland To Which Are Appended All Accounts Annexed To The Evidence And Report Of The Committee Of Parliament, On The Bank of England Charter In The Session Of 1832*, (London: Sherwood And Co). On page five the book does suggest that most of the core of its argument arises from an article of the same title, in the *London Encyclopedia* of 1833.

¹⁹ See Hoppit (1986), for an overview of successive financial crises in eighteenth-century England.

²⁰ The tax was a multiple levy on the existing assessed taxes, and it did also contain an income tax. In addition, the structure of the tax law continues the principle of graduation. Also evident was the bottom threshold which sort to protect the less well off and an upper threshold which capped the amount payable. In short the triple assessment was a simple and early form of progressive taxation. Further the conceptual approach and the structure of the tax is similar in some ways to the property rate applied by Governor Fitzroy in 1844 New Zealand.

6. 1. The Progress of Direct Taxation

Direct taxation i.e. the arrival of income tax, was achieved in two steps. In 1798, there was “a trebling of the assessed taxes, the infamous Triple Assessment” (Kozub, 2003). The assessment, supposedly, impacted unhappily on a small number of the wealthy (Steinmo, 1993, p. 54). For government however, their new property and income tax had real difficulty in assessing income, and in ascertaining a person’s property. Furthermore, its ineffective nature and poor method of application made evasion possible.

For taxpayers, they were annoyed because the tax did not differentiate between wealth (capital) and income sources; plus, the tax was unreasonably inquisitorial (Douglas, 1999, p. 40). At this juncture it is important to note that this latter compliant did lead to the provision of today’s constitutional rights for taxpayers. Those rights are now built into the compliance and collection procedures thus, taxpayer have an avenue of appeal, a right of redress and some secrecy²¹.

Ultimately the Triple Assessment was unproductive and consequently, repealed. Introduced in instead was the *Income Tax Act*, 1798 which became law in 1799. The Act was a quasi flat tax of 10%, with exemptions and marginal graduation. The revised initiative “took the easy step from being a tax based on the presumption of one’s income, to a general tax upon all income” (Hartwell, 1981, p. 146, in Daunton, 2001, p. 184). The concept is recorded as coming from the King of France, Louis XIV (1643-1715) who in 1710 imposed a tax on all incomes under four schedules (Sabine, 1980, p 114). The revised income tax of 1798 would find its success in adopting this scheduler approach. As per the schedule attached to the 1798 Act, those with incomes below a set level were exempted, and in words that echo through the years in New Zealand budget speeches (*Appendix to the Journals of the House of Representatives of New Zealand*, 1854-92), the new tax was as close as was humanly possible to a fair and equitable contribution. However, was that really the case, or was it just rhetoric?

6. 2. Winners and Losers of the Century’s New Direct Tax Initiative

In matters of taxation, equity and fairness are often more understandable by way of thinking in terms of winners and losers. With respect to the 1799 income tax for example, according to Samson, Parliament at the end of the seventeenth century was made up of the landed and moneyed classes who reportedly sought to avoid paying taxes on that wealth (Samson, 2002). The income tax those persons agreed to, was a compromise i.e. an alternative to land taxes. The income tax was also recognised by the ruling polity as being “an alternative to increasing indirect taxes which burdened and retarded trade” (Adams, 1993, pp. 349-352), and those persons actively in trade were another major interest group of the period.

²¹ It is worthwhile to note in passing that in the current climate of taxation there are financial liabilities which are collected by and through the tax system. They are technically not considered taxation by law and as such do not have all the protections of ordinary taxation – meaning, they are inquisitorial and oppressive. Yet it is arguable that in form and substance they can legitimately be said to be taxes. The loss of taxpayer’s constitutional rights and an erosion of their freedom is the result. But, this is a matter for further research and will not be entertained in this thesis.

Evidence of the above mentioned approach to equity and fairness may be found in the record of tax revenue post 1799 and into the new century. As mentioned previously and exhibited above in Figure 4.4, initially the income tax appears to bring a halt to rising taxation under other heads. However, post 1803, and this will become apparent in the assessment of the next century, Land and Assessed taxes remained static but Excise taxes once again exhibited significant growth; as did Customs and Stamps. Furthermore, alongside these changes in the revenue collection, the income tax, at least initially, did not perform at all well.

What then was the purpose of the income tax? The income tax supposedly had many other societal positives, sparing most of the population, and in terms of the social contract, the income tax was supposed to be a trade off for reductions to indirect taxation which from the evidence didn't eventuate. The wealthy were no doubt acutely aware that base broadening along these lines would shift the burden and avoid the necessity of increasing Land and Assessed taxes, which the income tax did. In tangible terms then, those societal positives were limited to the existing principal actors in the political economy – the winners, and the losers were the larger subordinate population.

Fiscally, whether the income tax had the ability to meet short term revenue needs or not, and whether that was its purpose is, on the evidence of revenue returns, highly debatable. The reality; the income tax was simply further tinkering with the existing measures of taxation. In principle the income tax combined several older taxes with the end goal being, to proportionally tax all incomes with the exemption of a fixed sum. The income tax was seen as being “no different from the older direct taxes, although a departure in method” (Plehn, 1902, p. 137). The fundamental difference at this juncture was the new economic sophistication and improved financial organisation that existed within the institution of government. Now the ability to effectively tax income and wealth was beginning to match the will of the state – in this instance the Crown. Implementing effective “direct taxation [was now, in conjunction with being an avenue for constitutionalism]... politically acceptable and a practical possibility (Seddon, 1968, p. 3).

7. CONCLUSION

The story of New Zealand's English heritage is not found in the New Zealand literature and this discussion paper has been a second attempt to fill another small part of that gap. The paper made this an objective and thus, the work has achieved its first goal. The second objective was to answer two questions: What is the English experience of taxation; and, how did their tax system evolve from 1701 to 1800 i.e. what were the drivers of eighteenth century tax reform.

The Analysis of paper has not found any reason to disagree with the stated hypotheses of Subsection 3.2. However, it is possible once again to offer some additional insights. The information summarized in Section 3 of Part I of this series indicated, that the fiscal initiatives of the seventeenth century were indirect tax; direct assessments and by the end of the century, funded debt. This approach to applied taxation maintained the political balance and allowed successive governments to meet their fiscal purpose. Further, over the course of

the seventeenth century “fiscal policy had been influenced and reshaped by financial stress and the bargaining power of narrow interest groups” (Hartwell, 1981, p. 152). This inevitably led to an expansion of the tax base at century’s end (Seligman, 1925). After 1700, “fiscal thought tended to favour a tax system which spared the land.... and those previously exempted on compassionate grounds would be asked to contribute” (Sabine 1980, p. 97-98). This major change in fiscal policy was in accordance with a philosophical movement away from the ability to pay principle to a pre-utilitarian benefit principle. All the hypotheses of the literature were found to hold and the key driver of taxation policy was identified as being crisis, both external and internal.

The analysis undertaken in Section 3 of this second paper in the series has suggested that it may be contentious to state that taxes were high and maintained so during the course of the eighteenth century. It is also contentious to simply explain this statement by way of saying that methods and principles i.e. those established at the end of the seventeenth century were responsible. Nor does analysis find that the fiscal requirements of conflict (external crisis) are an outstanding or complete explanation for tax policy development during the eighteenth century.

Further, to suggest that taxes were regressive during the period is reasonably plausible and this was compounded by the fact that the British economy was still basically agrarian, throughout the century. In addition, the fiscal system, which relied on indirect taxation, had limits on how much revenue it could generate. The continued use of this system of taxation may have been driven by a continuation of the dominant economic philosophies of the time. Further, it is arguable that taxation had been, during most of the eighteenth century, constrained by the lack of economic sophistication and the undemocratic forum that was Parliament during the period. Only the former (economic sophistication) would have changed by 1800.

If rates and measures of taxation did change or increase during the eighteenth century, and this is known to have occurred, change can be considered to have occurred in order to combat inflation, and tax increases were required in order to maintain a revenue neutral position. That fiscal neutrality needed to maintain a social balance, a balance that was, of the preferred ideology of the period; the seventeenth century principle of taxation - the ability to pay. This philosophy would continue right through the eighteenth century as the body politic of the period continued to redistribute the tax burden. The change (development of tax law and practice), relied on indirect taxation impacting the previously exempted lower classes, the merchants, and the industrialists.

This process, in my view, was ably assisted by economic progress and population growth. Lastly, the idea above, that inflation was killing the revenue and thus drove tax changes is an interesting proposition and quite plausible on the evidence. However, the financial activities of government, during an early period of financial evolution also impacted the economy and this point is of some importance to any discussion of tax reform during the period.

All of the issues discussed above, in conjunction with socio-economic conditions did alter the eighteenth century social contract, and during the period this is made base broadening inevitable. The means of attaining fiscal purpose thereafter – from the end of the eighteenth

century - would include the direct taxation of property and incomes. The paper does therefore, find that the hypotheses of the literature have not been proved wrong but analysis has offered some additional insights with respect to the drivers and constraints of tax policy. The hypothesised drivers were: War, and inflation. The additional insights are: population growth, industrialisation, the financial intermediation sector, financial crises, and the political economy of Parliament and Britain.

The introduction posited five hypotheses. The hypotheses of the paper are commented on in numerical order. First hypothesis, the key to understanding taxation lies in determining the period's principle of taxation. At the beginning of the seventeenth-century the standard was the benefit principle. At the end of the seventeenth and the beginning of the eighteenth the principle was the ability to pay and by century's end it was the augmented benefit/ability to pay principle. Thus, a minor alteration to the underlying principle of taxation did occur during the century. The principle is however, not considered to be the key driver of change for tax policy during the eighteenth century.

Second hypothesis, the balance of applied taxation regularly changes from indirect to direct taxation and back again over time. This hypothesis has been shown to be valid in both papers. During the course of the eighteenth century indirect taxation was the norm however, by the end of the century a new direct tax initiative was established. Nonetheless, by the end of the century the main method for raising revenue was still indirect taxation.

Third hypothesis, throughout recorded history, crisis is the arbiter of change. This is the interesting hypothesis because as the first paper in this series indicated, our English Heritage is strewn with the detritus of war. Furthermore, in the Eighteenth century British tax history literature war is presented as the arbiter of change i.e. external crisis. However, the important point is that there were also many internal crises. For example Hoppitt (1986) identified 13 periods of financial crisis, eleven of which he related to difficulties in the public finances. This is also seen as being a major influence on the development of taxation. Therefore, crises (both external and internal) are the key drivers of tax policy development.

Fourth hypothesis, economic thinking is a major influence on tax policy development. Once again, it is difficult to speak of the fourth hypothesis independently of the other hypotheses. As stated in Part I; there is always and, at all times, an overarching framework of ideas and an ideological component attached to fiscal and political thought and this paper focused much attention on this aspect of eighteenth century tax evolution in Sections 5., and 6., and therefore, this hypothesis has also being found to hold.

In addition, the fifth hypothesis; the politics of tax ultimately decides the final form tax policy will take. That the politics of tax is implicated in the evolution of taxation is once again found to have merit. For example, there is the quote found above; "fiscal policy had been influenced and reshaped by financial stress and the bargaining power of narrow interest groups" (Hartwell, 1981, p. 152). This aspect of tax policy development, in conjunction with the other four hypotheses, will be further discussed in each of the further two papers which follow.

This paper has critically assessed the literature for the period 1701-1800. This second paper has also begun the process of constructing benchmarks that may enable future comparative analysis to be undertaken. Furthermore, the work has now established a simple framework for analysis. That framework will be replicated in the third paper of this series; Part III, 1801-50.

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