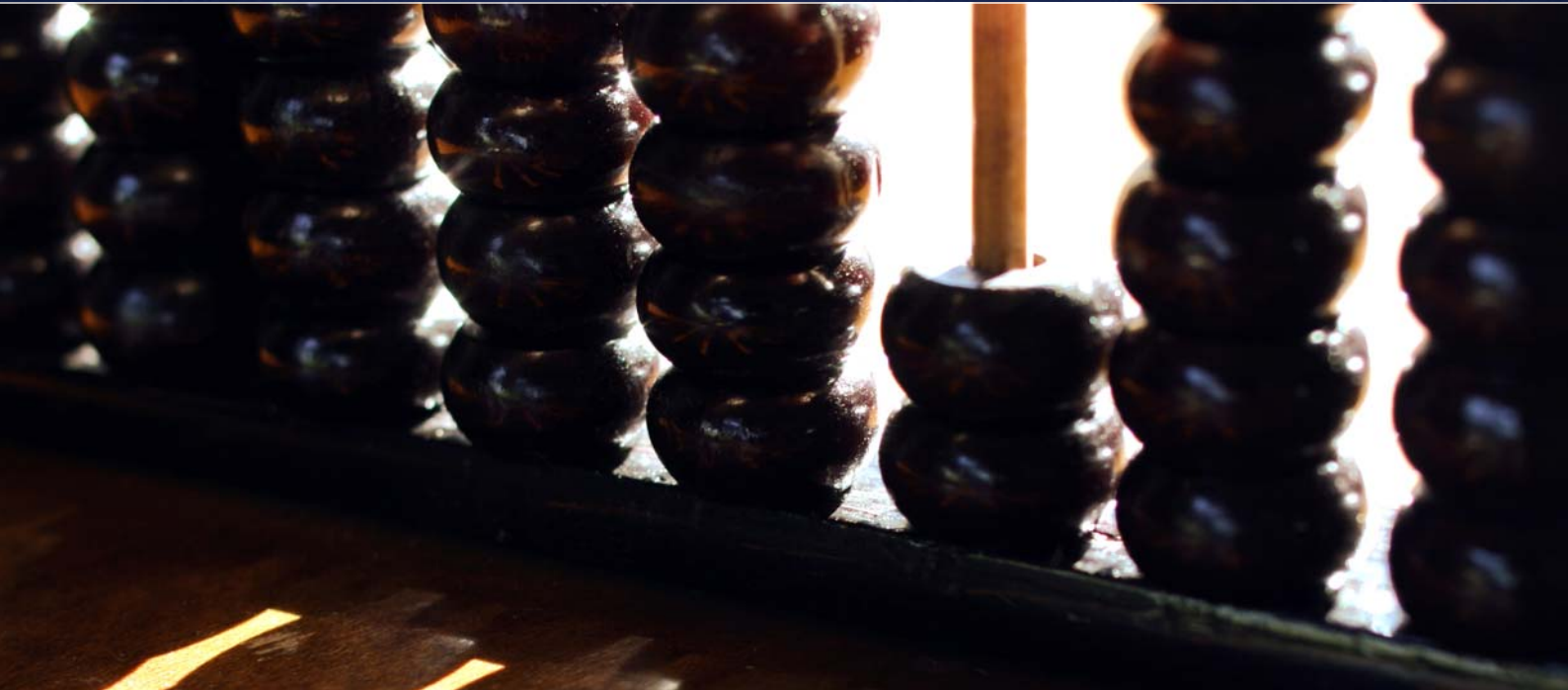




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NEW ZEALAND'S FISCAL INHERITANCE
An Assessment of the Development of Direct
Taxation in the Mother Country Part IV: 1801-1850

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NEW ZEALAND'S FISCAL INHERITANCE

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

PART IV

1801-50

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ABSTRACT

This paper is a review of the development of British taxation during the early nineteenth 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 tax system. This, the final paper in a series of four, focused on the development of income tax policy during the early nineteenth century. The findings are; that the underlying principle of tax did tip in favour of the ability to pay principle. The tax base was enlarged, and the method of taxation still remained indirect yet a revised direct tax initiative was firmly established in 1842 – the income tax. Thus the balance of taxation changed yet the social balance according to a wealthy minority was still the status quo. In addition to the politics of tax and economic thought influencing the process, a new ideology of free trade would drive the development of the income tax during the period. Finally, the driver of tax reform during the period was still crisis; first external and most interestingly internal crisis i.e. first financial and second recurrent deficits.

JEL: N, Economic History

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

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1. INTRODUCTION

The first, second, and third paper in this series began by stating that New Zealand was established in 1840 as an Administered Crown Colony; a small part of the British Empire. Therein, was a comment from Hooper et al (1998) which described the European experience that settlers brought with them as being, our English heritage. However, all previous papers have noted that the evolutionary details of British taxation policy are not found in the New Zealand tax history literature. Therefore, the question for the series of papers was to ask; what was the European experience of developing fiscal policy and of direct taxation in particular.

The purpose of this final paper, Part IV², is to continue to fill a small part of the large gap that Hooper et al (1998) identified in Part I. 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 developed in the first two papers; the methodology that was derived from our understanding of McKinnon (2003, p. 11). That the genius and evolution of New Zealand's fiscal (tax) policy is the 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, this paper will consider the development of the British income tax during the early nineteenth century; detail the process of change, and attempt to identify the drivers of that nineteenth century tax reform. Furthermore, this paper will conclude the and therefore the conclusion will include material from all four papers in the series.

Once again, this paper acknowledges that a necessary requirement of scholarship is a statement of direction. Thus, the five tentative suggestions of the first, second, and third paper have also become the hypotheses for Part IV 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 reviews the periods Politics of Tax with respect to income taxation. Section 4 considers the development of the 1842 income tax. Section 5 summarises

² This discussion paper is the third of three which focus on the Fiscal heritage of New Zealand. The intention was to begin with the years 1600-99, and thereafter to focus attention on the two centuries where statistical data is available. This will enable a critical assessment to be undertaken of the two periods in question. Therein, in the last two papers, the discussion moves toward the development of 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).

the century's response to the development of income tax policy, and section 6 concludes Part IV. Section 7, concludes the English Heritage series.

2. METHODOLOGY

In McKinnon's history of the New Zealand Treasury (2003, p.11), he comments on the centuries of English history 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 the many years of fiscal evolution. Alley, et al, (2004) tell 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 English experience of tax policy development into three periods. Part I lacked statistical data and therefore, was a summary of the seventeenth century. For Part II and Part III, there was an abundance of statistical data and therefore, the paper attempted a critical overview of the eighteenth century. This paper is Part IV, and in a fashion more closely aligned with Part I the approach is to review and summarise for the years 1801-50, the political economy associated with the development of the UK *Income Tax Act, 1842*. Analysis ends in 1842; however, as Part IV is the last paper in the series the summary and conclusion sections will take account of the body of work undertaken herein.

The subordinate approach (method) of this paper is similar to the first in the series. The method 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).

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 statistical tables for the period 1700-1850 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, where different studies use similar data there can often 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 section on 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. The prices series used in the study are also from Mitchell and Deane (1962). The relevant page numbers for Mitchell and Deane are appended below the figures and tables as they appear in this discussion paper. All data series used in this paper were changed only once and that was from nominal values to real values. The limited fiscal data presented in the paper is in the form of line graphs, and with the underlying data, some simple analysis has been undertaken. However, the use of long-run historic data does require some qualification and there are several reasons for this caution.

One reason, for example, derives from Mathias and O'Brien (1976) "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). In accordance with Mathias and O'Brien (1976), even a simple inspection of the data used herein reveals a disturbing similarity between all series. While a relationship between variables is expected, the pattern evident in some of the data does raise questions of a methodological nature. However, an investigation of the construction of each variable is outside the scope of this paper. This completes the Methodology section of the paper, attention is now turned to the development of British tax policy during the nineteenth century.

3. THE POLITICS OF TAXATION

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 early nineteenth century with an especial interest in the development of period's evolving policy for the taxation of incomes.

3.1. Toward the 1842 Income Tax

Smith (1820, in Hartwell 1981, p. 130, and Horstman, 2003, p. 111), suggests that "the English believed they were a heavily taxed people" during the period (1801-50). I conclude that heavily taxed is a subjective term and the question could be asked; they believed they were heavily taxed in comparison with what? Or, one could ask: by what standard of measurement did they feel heavily taxed.

Some studies, such as Mathias and O'Brien (1976), compare English with French taxation; I suggest a different comparison. The comparison is with the experiences of those paying taxes prior to 1800: "taxation memory went back to pre-income tax days to a period when national debt was low[er] and government expenditure was tiny [smaller]" (Hartwell, 1981, p. 133).

Irrespective of popular opinion (or the views of differing authors, see above, whose contradictions may be due to the different time periods that they examined) as Britain moved toward the 1830s there would be much change to fiscal policy; first a repeal of the income tax and reductions to the indirect taxes, thereafter, there were increases to the existing indirect taxes and finally to complement the indirect taxes, a renewal of direct taxation. This period in the life cycle of income tax policy is discussed below.

3. 2. The Income Tax: 1803 -1816

The unpopularity of Income tax had not diminished by 1802, and in the same year Parliament repealed the Act. The consequent fall in revenue lead to predictable increases in other taxes, namely Excises and Stamps. With war returning in 1803 so did Income tax, but at a lower rate of 5 per cent and under a new schedule⁵ which differentiated between income sources and types of income. The separate schedules of the 1803 Act are listed below in Table 5.1.

Table 5.1
Income Tax Schedules: 1803 Act; Codified in the Act of 1842

Schedule A: rents of real estate and houses.

Schedule B; profits from the occupation of land i.e. farming.

Schedule C: profits from Government stock and bonds.

Schedule D: profits from trade, commerce and the professions.

Schedule E: Salaries and pensions from office.

(Hope-Jones, 1939, pp. 20-21. In Daunton, 2001, Table 7.1. p. 185)

Aside from the revised scheduler system, seen above in Table 5.1, the renewed income tax of 1803 also contained deduction at source where appropriate (deduction at source was a major innovation for taxation and is a mainstay of modern tax systems). The 1803 Act was a system of taxes on separate revenue flows; the new Act modified the old system of property taxes, and had a more comprehensive wage and salary addition.

“The new direct tax system would also contrast with the fixed measures of the indirect tax imposts by being more amenable to variance in the rate, to meet the changing requirements of Government” (Douglas, 1999, p. 42). In any event by 1815 and the end of the war with France, there had being sixteen years of income taxation; during the period there were several rate changes i.e. one reduction and two increases. After the war with France “political opponents to the income tax had the justification needed to demand its repeal. The Government of the day suggested reducing the income tax to 5 per cent but the political consensus, constructed by the conservative elements were against income tax being retained at all” (Steinmo, 1993, p. 54).

⁵ The income tax was based on the French imposition of a tenth which differentiated by way of 4 schedules, real estate, salaries, securities and business.

“Opponents argued, that the emergency had passed and [that], an income tax was no longer justified” (Douglas, 1999, p. 44). Thus, in 1816 the tax was repealed “on the grounds of injustice, fraud and the ability of those, with any liability, to seek recourse by way of submitting false returns” (Coffield, 1970, p. 104). During the repeal debate, sector groups also negotiated further concessions for land and agriculture which at the time were economically depressed (Douglas, 1999). The government acquiesced and abolished the malt tax as well. Between the years 1816 and 1830 there was little interest in the taxation of incomes however, from 1830 onwards that would change.

3.3. The 1830's

The emerging fiscal reality of the 1830's would be a contrasting picture of reduced tax burdens for some sectors at the expense of others, as tax repeal and incident shifting continued. However, when the reality of increasing indebtedness dawned, the essence of the debate changed. A select committee on taxation was appointed in 1830, but no fiscal reform resulted.

Over the years before and after 1830, several authors, including for example, Henry Parnell (Parnell, 1830) published on the subject of public finance. “There was the idea of imposing income and property taxes as a substitute for the existing system of taxation” (Sabine, 1980. p. 121). However, political and economic idealism moved in another direction. “The salt duty was abolished, male suffrage was extended and slavery was abolished in 1832” (Douglas, 1999, p. X). All of these fiscal initiatives can be said to have impacted on tax policy viz. the need for increased expenditure. For example, the abolition of slavery added to public debt when in the government of 1833 committed to compensation for slave owners⁶ but, there were also positive externalities to consider. The demand for public goods was also about to increase and this would lead to much new social expenditure: for example, the loan raised to pay for emancipation also helped top fund beginnings of state education.

Nonetheless, the year 1832 saw the House pass the first Reform Act and this enactment marked another major change in the British social contract. As usual, taxation would play a significant role. The Reform Act broadened the franchise and also delivered the foundations (framework) of the Westminster system of government that we have today. This system, in my view, was constructed on the basis of the following doctrine: “the statesman.... must hold the reins; and not commit the management of the horses to the discretion of those whom he is employed to conduct” (Steuart, 1998, (1767), vol. 2: 34).

In other words, the social structure in society was assumed as given; there are those who rule and those who are ruled. This philosophy underpinned the British polity and the social contract of the period. Understanding this philosophy is necessary for those who seek to examine the development of taxation during the early nineteenth century in Britain or New Zealand. Political power was in the hands of a small interest group who controlled the process of institutionalism i.e. created the rules, and controlled the direction of the political game for several generations into the future. It is a salutary thought that not until the twentieth century that a representative democracy was achieved (Coffield, 1970, p. 65).

⁶ See Sheridan (1961) for an interesting discussion on the abolition of slavery and the cost to the British taxpayer.

If, as suggested, the Reform Act entrenched the positions of those who had become used to ruling, it is plausible to subscribe to the view that government (what we now think of as the arbiter of interest group activity) is also an interest group. This accords with the view of Olson (1965), and it is important to understanding the process of fiscal development and change. The political system herein described has directed tax policy since that date, 1832, and the welfare of the elite interest group was given great attention; this is evident in the record of their activity.

3.4. Minority Interests

There was a second Select Committee on Taxation in 1833, but no noticeable policy resulted. Parliament's attitude to increasing social, political, and financial pressure by 1835/36 was still to reject direct taxation of income. Parliament considered indirect tax the proper source of income in peacetime and considered direct taxation, in the shape of property taxes, the proper source of income in times of war. Sabine reports that an eminent political economist of the period, Ricardo, with the support of a burgeoning ideology expressed by the Manchester School⁷, favoured the idea of reintroducing income tax as a tax in both peace and war (1980, p. 121). Such views, however, did not prevail.

Political debate aside, any strategy that was developed to promote the interests of minority sectors of the economy only, was very likely to become increasingly untenable, both socially and financially. But, "with land still the chief source of wealth and political power in the country, the tax system would reflect as much. [The tax system apparently] existed on a narrow base and was [to remain] fiscally regressive" (Daunton, 2001, p. 77). "Indirect taxes on the necessities of life, malt, sugar, tea and tobacco would and did, account for over 40% of all tax revenues and the middle class and working class paid nearly 90% of those taxes" (Martin, 1833, in Horstman, 2003, p. 128)⁸.

Any fiscal reform of the 1840's would have to impinge on the wealth and capital of the socially and politically powerful. Taxation reform would need to focus on the wealth of these groups because (as mentioned above) business and commerce and the lower classes perceived themselves to be, already, heavily taxed and there are reasonable grounds to agree with their view. Tax reform would need to increase the burden of taxation on the wealthy and powerful and then redistribute the revenue gains as reductions in taxation among the industrial and commercial classes. Providing the powerful and wealthy could be persuaded to agree, adopting this balanced approach would deliver the support required for government to undertake major change to fiscal and social policy.

⁷ The Manchester School was the term British politician Benjamin Disraeli used to refer to the nineteenth-century free trade movement in Great Britain. The movement had its roots in the Anti-Corn Law League (ACLL) of Richard Cobden and John Bright, headquartered in Manchester, UK. The ACLL was set up in 1836 and, by 1846, had succeeded in having the Corn Laws repealed by the Parliament. Since then, the general term Manchester School has been used to refer to radical liberalism/libertarianism in economic policy: *laissez-faire*, free trade, government withdrawal from the economy, and an optimistic stress on the "harmonious" effects of free enterprise capitalism (Gonçalo Fonseca, 2006).

⁸ Horstman (2003, p. 128) suggests that these are personal estimates only and are based on a lower figure for the working class population than present estimates suggest.

Furthermore, the proposed changes to the burden of taxation would be used to give limited relief to the lower classes and thus satisfy some social equity requirements. Such relief harked back to the days of the Tudors. It also indicated that politicians were aware that the lower classes were becoming increasingly unhappy. With an indirect tax system, the burden was being borne disproportionately and by those without a voice in Parliament. Furthermore, a large number of people were becoming increasingly dissatisfied with the results of social change since the industrial revolution.

One way for the government to achieve these multiple fiscal objectives was the fundamental tax reform of 1842. This fundamental reform would alter the entire the tax system by shifting the balance of taxation from indirect to direct taxation. Thereafter, the tax base away would incrementally move away from its reliance on expenditure and consumption and toward property and income taxes. The questions that arise are: would the fiscal objectives be met and would social equity be achieved via changes to the tax system; and finally, what would persuade minority interest groups and the wider population to accept the fundamental tax reform described herein.

3. 5. 1842: Crisis and the Income Tax

There were twenty six years between the 1816 and 1842 (the two turning points for direct taxation). The changes would coincide with a restructuring of the indirect tax system and base broadening measures aimed at maintaining the revenue. The quote below is taken from the budget speech of the incoming Government of 1842, and provides a brief history of the income tax from 1798 until that date.

“In 1798, when the prospects of this country were gloomy, the Minister had the courage to propose, and the people had the fortitude to adopt, an income tax of 10 per cent. The income tax continued till the close of war in 1802; and in 1803, after the rupture of the peace of Amiens, a duty of 5 per cent was placed upon property. It was raised in 1805 to 6¹/₄ per cent and in 1806 again to 10 per cent; and so it continued to the end of the war⁹. I propose that the duty to be laid on property shall not exceed 3 per cent.....Under the former duty, all incomes below £60 were exempt from taxation, and on incomes between £60 and £150 the tax was on a reduced rate. I shall propose that from the income tax I recommend all incomes under £150 shall be exempt.”

(Sir Robert Peel, Prime Minister; Speech in the House, 1842. In Phillips. 1959, p. 313-322)

The circumstances, under which the application began in 1798, and for its re-introduction, are given as internal crisis. This was a line of reasoning found useful in justifying its re-introduction outside of external crisis conditions. Also notable from the extract are the rate of the tax and its variance over time, and the income threshold which exempted the less well off and maintained social equity. All of the above methodology was to become an accepted method and its operation can be seen in the introduction of the early property and income tax laws in the colonies i.e. New Zealand.

⁹ The Income tax act was repealed in 1816, to be reintroduced in 1842.

New Zealand aside, a direct tax like income tax would broaden the tax base and provide relief for the working class and poor if instituted in conjunction with other reductions to indirect taxation. While the income tax had the ability to impact land, capital, rent, profits, wages or a mix of them all, the central concern was the balance among sectors. According to Daunton (2001) the political reality reflected the real requirements of agricultural, shipping and the mercantile sector. Determination of the tax changes would need to meet the neutrality requirements of each of these groups.

Assistance came from crisis and the form it took was a prolonged economic depression which was well entrenched by 1840. The contagion effected America, Australia and New Zealand. The following year, 1841, Britain held an election, with the main argument being, the economy, fiscal policy and taxation. The general election poll of 1841 saw the Whigs lose office and the Tories take the political reigns. With the advent of a new government came a new Prime Minister Sir Robert Peel and a new Chancellor of the Exchequer Henry Goulburn.

The new Exchequer considered that “the laissez faire theories of Adam Smith and the politically popular views on taxation had produced a policy of fiscal expediency leading to national bankruptcy” (Sabine, 1980. p. 121). What had being a very complicated and unpleasant argument concerning privilege and social equity was finally about to become abundantly clear to all. Policy was going to change, and the incidence of taxation was about to be redistributed.

Whatever the belief was about laissez faire, industrialisation had created and the need for a more, responsive and expanded Government (Steinmo, 1993). Irrespective of the ideological or political pressures of the day, the new Government of 1842 believed they had a mandate for change. To rectify the economic depression they proposed an income tax, coupled with the restructuring of customs. Steinmo (1993, p. 54) suggests that “it was to fight the evil deficit and act as a buffer until free trade reignited growth”¹⁰.

For the British government at the time, there were thought to be limited choices: borrow more; increase indirect taxes on commerce; increase the assessments on land and wealth; or increase taxation on the working class. None of these were politically or socially tenable. Therefore, as per the social contract that had evolved since 1086¹¹, there were political negotiations and the result was a compromise. Because it was a financial emergency and thus, seen as a crisis, Income tax was accepted and lesser reductions, than those asked for in respect of general customs duties, were implemented.

The approach of Peel’s government would supposedly stimulate demand in the depressed economy and provide a relief to many. This is also a key concept voiced by Fitzroy during his tenure as New Zealand’s second Governor. This moment in British economic history is described by Sabine (1980, p. 121) as “a period of confusion and darkness”, a phrase that

¹⁰ “.... to fight the evil deficit and act as a buffer until free trade reignited growth” (Steinmo, 1993, p. 54); an idea that Governor Fitzroy would leverage in 1844 New Zealand.

¹¹ The Doomsday Book, can be viewed as an early Medieval a tax document, and thus a formalisation of the periods social contract.

with alteration has also being used to describe New Zealand's early years. It was clearly for similar reasons; economic depression and fiscal imbalance.

The closing statement of Peel's budget speech is appended below:

If you do not take this course which is now opened before you, if you do permit this evil to continue, you must expect the severe but just judgment of a reflective and retrospective condemnation – your conduct will be contrasted with that of your fathers when under difficulties infinitely less pressing than the present, and you will be told of the mutiny at Nore, and of the rebellion in Ireland, and of foreign disasters, under all of which with a buoyant vigour your fathers willingly and cheerfully submitted to a property tax of 10 per cent to relieve the country from its embarrassments. But no, I believe that you will not shrink from the contrast; that you will not act in a manner unworthy of your sires. My firm belief is that you will feel the absolute necessity of preserving inviolate the public faith, that you will not throw away the means of preserving the public credit, and that you will in the most legitimate manner reduce the public burdens. My hope and firm belief is, that when I devolve that responsibility upon you, you will prove yourselves worthy of your mission with which you are entrusted – of your mission and functions as representatives of a mighty and intelligent people – and that you will not tarnish that character, which is your duty to cherish as your most glorious inheritance, that you will not impair your character for fortitude and good faith, which, in proportion as the empire of opinion supersedes and predominates over the empire of physical force, constitutes for every people, but above all for the people of England – I speak of reputation and character – the main instrument with which your people can repel hostile aggression and maintain extended empires.....

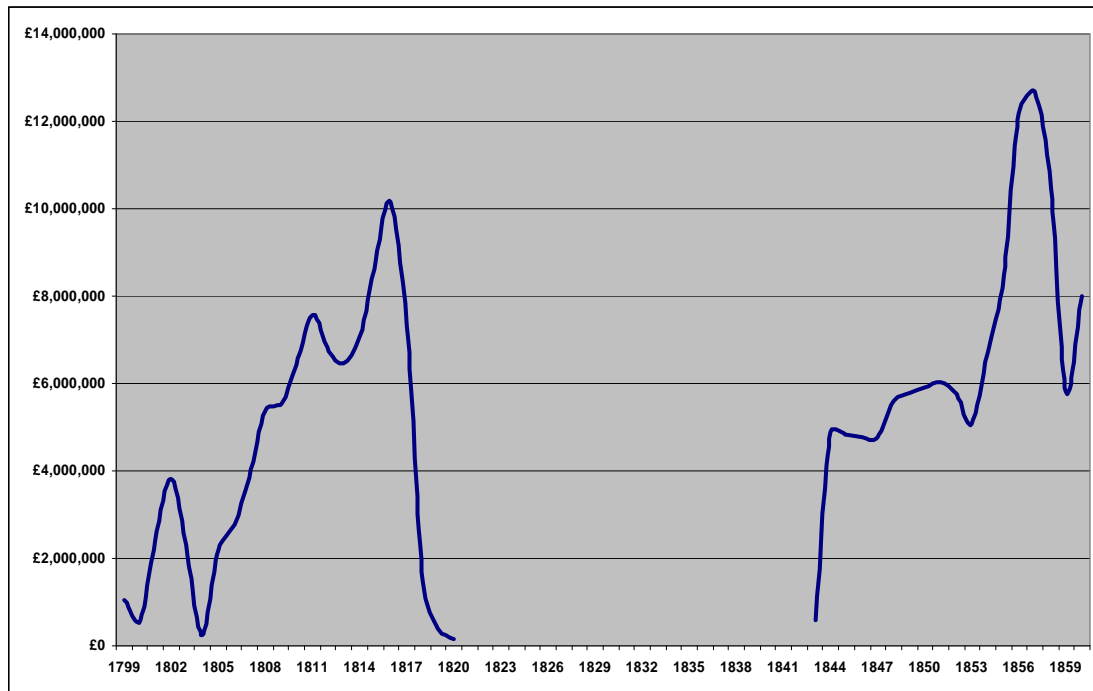
Just picture it!.....All that oratory for sevenpence¹²..

(Sir Robert Peel, Prime Minister; Speech in the House, 1842. In Phillips. (1959). p. 321)

“What converted the income tax from a radical idea to a Peel proposal was a string of deficits in the late 1830's.... the income tax would supply the money to tide the budget over until the effects of free trade would produce growth and raise the remaining taxes” (Horstman, 2003, pg. 128). This was of course not a short term proposal. Taxes take time to become effective and this is borne out by the evidence. The Income tax returns for the period 1798-1868 are appended below in Figure 5.1.

¹² (Phillips, 1959, p. 321). The words not in Italics are William Phillips.

Figure 5.1
Revenue from Property and Income Tax: 1799 to 1899



(Deane and Mitchell, 1962, pp. 381 – 431)

The immediate returns from the income tax at each of the three separate impositions during the early nineteenth century did not immediately provide large amounts of revenue, taking in each instance several years to produce sizable returns. This last point can be seen clearly in Figure 5.1, above. The movement from 1842 to 1844 and its plateau, was achieved in two steps, zero to £600 then to £5,300¹³. The first year returns are clearly no indication of the revenue worth of an applied income and property tax¹⁴.

4. THE DEVELOPMENT OF THE 1842 INCOME TAX

The focus of Peel's direct tax and of that his fiscal policy supporters may have been on the maintenance of the government's creditworthiness; however, there was also another key element to consider. That element was; how, in the face of a crisis which threatened the political status quo¹⁵, would the system of economic management be maintained? The direction was an innovation in political economy and reflected nearly two hundred and fifty years of tax policy development.

¹³ (Deane and Mitchell, 1962, pp. 381 – 431).

¹⁴ This fact does not seem to have been noted in the context of 1845 New Zealand and Governor Fitzroy's property and income tax.

¹⁵ For a précis of the status quo, the reader is directed to Brennan (2004), and Buchanan (2004), and Faith (2004).

4. 1. A New Political Economy

The answer to the question, in the face of a crisis which threatened the political status quo, how would the system of economic management be maintained, was in some part, the Income tax of 1842. “It was thought a most affordable purchase of future security” (Jennings, 1885, p. 359, in Daunton, 2001), as it would “integrate social classes, defuse potential social unrest and ultimately stimulate economic growth” (Daunton, 2001, p. 81). The result was expected to be prosperity and contentment (political stability) in the longer term¹⁶.

The new fiscal policy would be broadly accepted on the strength of the two underlying principles. One, the tax would reduce the cost of living for certain sectors and two, the tax would assist industry. Any shortfall in taxation that resulted from a reform of the indirect taxes was to be remedied by this expedient broadening of the tax base to include property and income.

Peel’s combined fiscal package (in reality, tax policy) would be sold politically to the general populace as fair; this rhetoric was a forerunner of statements found even in latter-day analysis of taxation reform (*OECD Economic Surveys*, 1984/1985, p. 25). The actuality of fairness, prosperity and contentment was not foremost in the minds of powerful sector interests; their support for income tax was derived from the renegotiated social contract and the consequent trade-off – of part of the possible burden of taxation.

Capitalists wanted to avoid another financial crisis like that of the 1820’s and they did not like deficits, which they perceived compounded inflation, undermined investment returns and destabilised the economy. The landowners remained protected by the agricultural laws (which did not begin to change until 1846, with the repeal of the Corn Laws¹⁷); commercial interests were protected by the progress of the free trade movement (and the reduction or repeal of many indirect taxes). The exemption for low income earners eliminated some of the tax burden for most workers. In general, the tax package can be said to have contributed to reduced political friction from the unrepresented and over-taxed. In this manner the neutrality between sectors of society was achieved.

Fiscally and philosophically, there were further important changes associated with the income tax. First, a move away from indirect to direct tax measures meant taxation was about to place more emphasis on the ability to pay principle. This apparent evolution in principle was hardly new; the augmented benefit/ability principle had been proposed by Adam Smith more than sixty years earlier and is found in his maxims of taxation. It can also be said that using this augmented approach to principle was not new either. Its application via the income tax however, was new, and the importance of this fact lies in understanding, that the change was in the index (the measure or gauge of an individual or entity’s ability to pay).

¹⁶ Prosperity, contentment and political stability, were something Fitzroy was also seeking for New Zealand in 1845 when he introduced the *Property Rate Ordinance, 1844*.

¹⁷ The debate over the Corn Laws was the most profound battle in political economy for a century or more. Works such as, Hollander’s “The Development of Ricardo’s Theory of Value” provides a peripheral but interesting discussion of its importance to the period (1904, 455-491). The protectionists had been agriculturalists as well as industrialists and merchants. The industrialists and merchants switched their position. Why? They came to accept the doctrines of modern political economy. The taxes had to change to replace the lost revenue from customs.

The old index was based upon the benefit principle and relied on the premise that a man's expenditure was the appropriate test of his ability to pay. Thus, the imposition of an indirect system of taxation was the result. The new index included the ability to pay principle and it took into consideration a man's wealth and income. For modern taxation, this was an important moment in the evolution/development of taxation.

Let us return to the 1842 Income Tax Act. Equity within the restructured tax system (liability and ability) was to be defined by a system of proportionality within the Income Tax Act. The Act differentiated between types of income to ensure that the burden of taxation fell equally. Equally, is a fairly subjective term, and difficult in practice to achieve. The proportional concept was accepted but everyone had to pay the same rate regardless of income level. Therefore, the income tax does not fully embrace the idea of ability to pay. Rather, than proportionality the benefit principle would still dominate and its acceptance would be based on a well established element of the social contract: that the taxpayer pays for the benefit received from the state and the distribution of income and wealth is taken as given and this would remain unchanged regardless of the new tax.

The political negotiations of 1842 also saw that the equality of sacrifice was not going to include graduated taxation (progressive taxation with the redistribution being the end game). According to Coffield (1970) this refusal to accept progressive taxation was the trade-off that capitalists and landowners demanded; there would be no graduation and no relief for earned incomes either. This latter point, relief for earned incomes, with some qualification, is still the case for modern income tax. Effectively the income tax favoured the two powerful interest groups "whose dominance of an unrepresentative Parliament worked against the interests of the industrial and mercantile sectors" (Coffield, 1970, p. 107). It is useful to recall the following statement of Dowell (1885):

Two-thirds of the strength of England we let escape; so that usurers, lawyers, tradesman and retailers, with all that troop who maintain themselves by our vice and luxury, and who make the easiest and most certain gain and profit in the Commonwealth, contributed little to its support.
(Dowell, in Coffield, 1970, p. 76)

"The immediate results of the new tax obligations; from a revenue perspective were dismal, with the yield being less than expected" (Sabine, 1980, p. 123). Yet, the government persisted and each year (as per convention) Parliament proposed and voted on legislation to renew the income tax. By 1844 the revenue from this source had increased significantly. In 1845 the tax was renewed again, as supposedly, it had helped turn budget deficits into surpluses. In part, and perhaps even because of surpluses rather than deficits, from 1849 onwards, the free trade movement was in the ascendancy (the movement was certainly helped by the reduction in indirect taxes, the repeal of the Corn laws, and the instigation of direct taxation to bolster the revenue).

Taken together, the results mentioned above, meant that there was not going to be a repeal of property and income tax legislation in the future. Instead, Successive British governments would continue to reduce indirect taxation and even some of the assessed taxes. Future

expenditure needs would be met from a much larger tax base, and an enlargement of the state's tax gathering ability, all made possible by the *Income Tax Act, 1842*. This concludes the section; the papers conclusion is included within the series conclusion found below.

7. SERIES CONCLUSION

The story of New Zealand's English Heritage, to date, has not been found in the New Zealand literature and this series of discussion papers has succeeded in filling a small gap in the literature. To achieve the single objective a compilation of four papers, spanning two hundred and fifty years (1601-1650) have being written, each covering a different era or aspect of British tax policy development. The story of the English experience of taxation, and of how their system of direct (income) taxation evolved from 1601-1850 was the second objective and this has now being successfully achieved. Finally, there was an indirect third objective; what were the drivers of tax policy development?

The work has not found any reason to disagree with the primary hypotheses of the limited, but important body of literature. Those hypotheses suggest that the key drivers of taxation policy are: War and Debt. They are also; therefore, implicated in the development of direct (income) taxation. However, after extensive analysis and a review of the literature, it is possible to offer some additional insights. In addition, the series of four papers has found much of interest to comment on and a summary of each paper is found below.

7.1. Part I: 1601-1700

Part I was the first in a series of four reviews which considered the British tax history literature. Lacking statistical data for the period, the paper was a brief summary only of the development of British taxation during the seventeenth century. The paper found that the seventeenth century was the moment in British fiscal history when three important institutional events occurred; the right to tax passed from Royalty to Parliament, a new fiscal innovation called funded debt began, and the rise of a revenue administration radically altered the system of fiscal management.

Nonetheless, the literature suggested that 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). The tax base was enlarged via the application of revised direct measures of taxation and changes to indirect taxation according to a new philosophy.

By century's end "fiscal thought [would] tend[ed] 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), and this philosophy would continue into the eighteenth century. The 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. Therefore, during the course of the seventeenth century, the underlying principle of tax changed. However,

while the method of taxation during the period alternated between indirect and direct taxation the principle means by the end of the century was still indirect.

Finally, the driver of tax reform during the period was crisis; both internal and external. To explain; the key crisis of the century, the Glorious Revolution, did result in major institutional change and the right to tax shifted from Royalty to the crown i.e. Parliament. In short, while there was conflict the important point is that it was an internal crisis, rather than external, and this is seen as being a major influence on the development of taxation during the seventeenth century i.e. crisis is a key driver of tax policy development – in accordance with the literature.

7.2. Part II: 1701-1800

The second paper in the series considered the period 1701-1800. Given the abundance of statistical data from 1700 onwards the paper adopted the dual approach of being both quantitative assessment and literature review. Extensive analysis suggests that it may be contentious to state that taxes were high during the eighteenth century, and were maintained so. 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 was considered to have occurred in order to account for 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 new 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 of incidence shifting and a broadening of the tax base, in my view, relied on 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. Analysis indicates that the driver of tax policy development was identified as being crisis, and not just external conflict but, internal financial crisis as well. The additional insights are: population growth, industrialisation, the interaction of the financial intermediation sector, successive financial crises, and the political economy of Parliament and Britain. Were also major influences on the direction of tax policy development and the driver of the development of the century's fiscal innovation, the property and income tax i.e. *The Triple Assessment* of 1798.

7.3. Part III: 1801-1850

The paper followed the structural approach of part II. However, given that the focus of the series of papers was concerned with the development of income taxation the work was divided into a quantitative assessment (this paper, Part III), and a review of the literature concerned with income taxation (Part IV). Therefore from the quantitative assessment undertaken in Part III the following can be said.

For the early nineteenth century the results of work may not strengthen the hypotheses of the literature, but once again they certainly do not weaken their case. For example, was more income transferred to government during the early nineteenth century? Yes, but there were plausible reason aside from North's (1979) theory of a predatory ruler to consider. For example, there was inflation, depression, population increases and economic growth. Also worth mentioning is that this paper analysed two different periods 1760-1860 and 1801-1850. The differing periods do derive a much different understanding of the economy, and this is exhibited in the paper's analysis of the changing tax system i.e. the period 1760-1860 exhibits a much different pattern to that for 1800-50.

Was war the key factor driving growth or change in taxation policy/revenue? From 1816 onwards external conflict was not as important as the previous century and is less of an argument for high and increasing taxation during the nineteenth century. Foreign policy as a determinant of tax policy development cannot be ascertained from the analytical approach. For specific items of expenditure, such as Debt Charges, being significantly culpable; it is uncertain as they altered pattern post 1816 and thus the argument that taxes were for one purpose – war - via the connection of cost and the consequent borrowing to pay for them, is not wholly plausible. The alternative, internal crises have more veracity. In the early nineteenth century loose fiscal policy resulted in recurrent deficits and a financial crisis in 1820, in tandem with the subsequent, it is assumed, poor policy response, which precipitated a major internal crisis. The paper finds that first, external and second, internal crises to be drivers of tax policy change during the early nineteenth century.

However, other items of importance to the development of tax policy during the nineteenth century are as follows: Between 1816 and 1842 the driver of change is identified as being

interest group behaviour and the politics of tax; first, there was repeal of income tax and reductions in the indirect taxes, then increases to customs and finally a new income tax. Nonetheless, tax revenue during the early nineteenth century was always going to do two things. (1), increase; and (2), increase as a percentage of GDP. The reason for this positive change in the revenue, as stated previously, is explained by a system of indirect taxation which responded to population growth, industrialisation, and the effects of inflation and deflation in an economy.

To summarise, the third in a series, finds for the early nineteenth century; that the underlying principle of tax did not change between 1801 and 1850, the tax base was enlarged, due to population growth and industrialisation, the method of taxation altered three times during the century, indirect/direct then indirect and back to indirect/direct. In addition interest group behaviour and the politics of tax played a significant role in the development of tax policy. Tax revenue during the early nineteenth century did increase subject to population growth, industrialisation, and in line with inflation and deflation in an economy. Finally, the driver of tax reform during the period was still crisis; first external and more importantly, recurrent internal crises.

7.4. Part IV: 1801-1850

Part IV was the final paper in the series of four which detailed the European experience that settlers brought with them; our English heritage. Part III was the quantitative assessment of the period, and Part IV was a directed literature review that discussed the development of the British *Income Tax Act, 1842*. Before discussing the findings of the paper the literatures' main hypothesis is discussed below.

The single hypothesis of literature was the idea of that during the period 1801-50, when income tax was evolving, that “the English believed they were a heavily taxed people” (Smith, 1820, in Hartwell 1981, p. 130, and Horstman, 2003, p. 111). The paper asked the question; in comparison to what, and the answer; in comparison to the experiences of those paying taxes prior to 1800. “Taxation memory went back to pre-income tax days to a period when national debt was low[er] and government expenditure was tiny [smaller]” (Hartwell, 1981, p. 133). Obviously, subject to the British *Income Tax Act, 1842* the story of Part IV was about political economy (the Politics of Tax).

The 1798 tax was still unpopular in 1802 and its successor the 1803 Act with its fiscal innovations of a new schedule and deduction at source, the key to making the income tax effective, would not change the status of the income tax with the taxpayers. At wars end, in 1815, the debate over the future of income tax would begin in earnest. Interest groups would successfully lobby for the taxes repeal in 1816. In addition there were also reductions to existing taxes, a move that would ultimately derive much fiscal stress two decades later.

Nonetheless, the 1830's would be impacted by much political debate as the promoters of the new ideology of free trade dominated economic thought. There was however, no change to taxation. Irrespective of David Ricardo or the Manchester School minority interest would still retain control over the development of tax policy. With the arrival of successive crises, and in the midst of a depression, the election of a new government would bring a halt to decades of

incidence shifting. The way forward was to be a fundamental reform of the tax system along the lines of the new ideology of free trade. The new initiative, a compromise, was to be a reduction in some indirect taxes and a new/revised income tax. The social and political status quo would be saved, the balance taxation would be redistributed, and the creditworthiness of the nation was assured into the future.

To close Part IV, the paper did find that the underlying principle of tax did tip in favour of the ability to pay principle; thus, an alteration to principle. That the interests of a wealthy minority were still going to be the status quo. In addition to the politics of tax and economic thought strongly influencing the process, a new ideology of free trade would drive the development of the income tax during the period. Finally, the central driver of tax reform during the period was still crisis; first external and most interestingly internal crisis i.e. first financial and second recurrent deficits.

7.5. *The Hypotheses of the Series*

The introduction to each paper posited five hypotheses. These hypotheses are commented on below in numerical order. First hypothesis, the key to understanding taxation lies in determining the period's principle of taxation. The period 1601-1700 saw a change in principle. 1701-1800 exhibited an augmented principle, and 1801-50 saw the rise of a dominate principle to accompany a new system of taxation. By 1842, the new index associated with the income tax meant that the ability to pay was that dominate principle. Therefore, each century the principle of taxation changed. The principle is however, not considered to be the key driver of tax policy development.

Second hypothesis, the balance of applied taxation regularly changes from indirect to direct taxation and back again over time. 1601-1700 the balance altered constantly, there were many attempts to utilise direct taxation to augment the revenue from indirect taxation. Most, if not all was less than successful and by the end of the century the main method for raising revenue was still indirect taxation. During the course of the eighteenth century indirect taxation was the norm however, by the end of the century, 1701-1800, a new direct tax initiative was established. Nonetheless, by the end of the century the main method for raising revenue was still indirect taxation. The early nineteenth century began with a mix of indirect and subordinate direct taxes. After 1816 the preference was for indirect and by 1842 the pendulum had swung back again to a mix of mainly indirect and a subordinate direct method of taxation. Therefore, the balance of applied taxation did change during the early nineteenth century. Thus the hypothesis is found to hold.

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 British tax history literature war is presented as the arbiter of change i.e. external crisis. The key crisis of the seventeenth century, the Glorious Revolution, did result in major institutional change and the exchange of the right to tax from Royalty to the crown i.e. Parliament. In short, while there was conflict the important point is that it was an internal crisis, rather than external, and this is seen as being a major influence on the development of taxation; at least during the seventeenth

century. For the eighteenth century 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. During the early nineteenth century there were also many severe internal crises; recurrent deficits, financial crisis and successive poor fiscal management. This is also seen as being a major influence on the development of taxation. Therefore, crises (both external and internal) are seen as being the drivers of tax policy development during the periods under study.

Fourth hypothesis, economic thinking is a major influence on tax policy development. It is a little harder to speak of the fourth hypothesis independently of the other hypotheses. There is always and, at all times, an overarching framework of ideas and an ideological component attached to fiscal and political thought. Each of the papers in the series has indirectly drawn attention to this issue and finds; for the seventeenth century evolution of tax policy, and for the eighteenth, and especially in the early nineteenth, this hypothesis strongly found to hold.

Finally, 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 found to have merit. For example, for the end of the seventeenth century/beginning of the eighteenth there is the following quote; “fiscal policy had been influenced and reshaped by financial stress and the bargaining power of narrow interest groups” (Hartwell, 1981, p. 152). This approach to developing tax policy would not change in the eighteenth century, in fact, by 1832 and the Reform Act, it would worsen. The view in the early nineteenth century was that “the statesman.... must hold the reins; and not commit the management of the horses to the discretion of those whom he is employed to conduct” (Steuart, 1998, (1767), vol. 2: 34). Thus, the politics of tax would continue to decide tax policy. This factor is, in the opinion of the author a subordinate yet equally important driver of tax policy development during the periods under study.

7.6. Conclusion to the English Heritage Series

This concludes the long-run investigation of our nation’s fiscal foundations – the British experience of tax policy development, 1601-1850. The series of papers has summarised, quantitatively assessed, and reviewed the British tax history literature. In the process the evolution of the single method of direct taxation outlined; the method of taxation which today, in great part, funds the advanced world. Furthermore, the work has shed light on the study periods’ drivers of taxation and established the relevance of other factors to the discussion of tax policy development. Thus, the twin objectives of the study have being achieved.

In the process of attaining the works objectives the following has been realised. The hypotheses of the literature, in respective periods, were found to hold however, in combination, the results of each paper allow the following comments to be made. In contrast to the literature; for the period 1601-1850 the key drivers of British tax policy development are identified as being: Crises, both internal and external – often in combination, and finally in conjunction with the politics of tax process.

Furthermore, the work has offered some additional insights with respect to the factors which seriously influence the process of tax policy development. Those factors are: the dominant or rising ideology of each individual episode in tax policy development, and the influence of economic thought. Finally, there are three key points of interest that are associated with any process of tax policy development.

First, the principle of taxation changes in line with ideology and economic thought – usually before - principle is seen as the support for the new or revised policy, that which has been decided by the politics of tax process. Second, throughout the period under study, the balance of taxation has being seen to change in line with incidence shifting, the purpose of which is to ensure neutrality is arrived at and to maintain the social balance and the status quo. This also is decided by the politics of tax process and was noted as being in the interest of a minority of the population. Third, the revenue has, at all times and for all of the periods under study, been seen to rise, and there are several reasons for this.

Revenue, and for that matter expenditure, was an increasing trend throughout the study periods, and the work of this series of papers does indicate why this might be. There is the familiar reason of rising expenditure and thus, more revenue is needed. However there is also population growth, economic growth, emancipation, improvements in administration, population concentration, the choice of tax methods indirect/direct, poor government, loose monetary policy, recurrent deficits, inefficient controls of the intermediation sector, and social demands. Finally, by the early nineteenth century the ability of government to garner other people's income started to match their will to do so.

To close the series; the fiscal experience of the early settlers to New Zealand has been detailed. That which is called our shared English Heritage is now a little bit better understood and a small part of the gap in the New Zealand tax history literature has being filled. This concludes this series of papers.

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