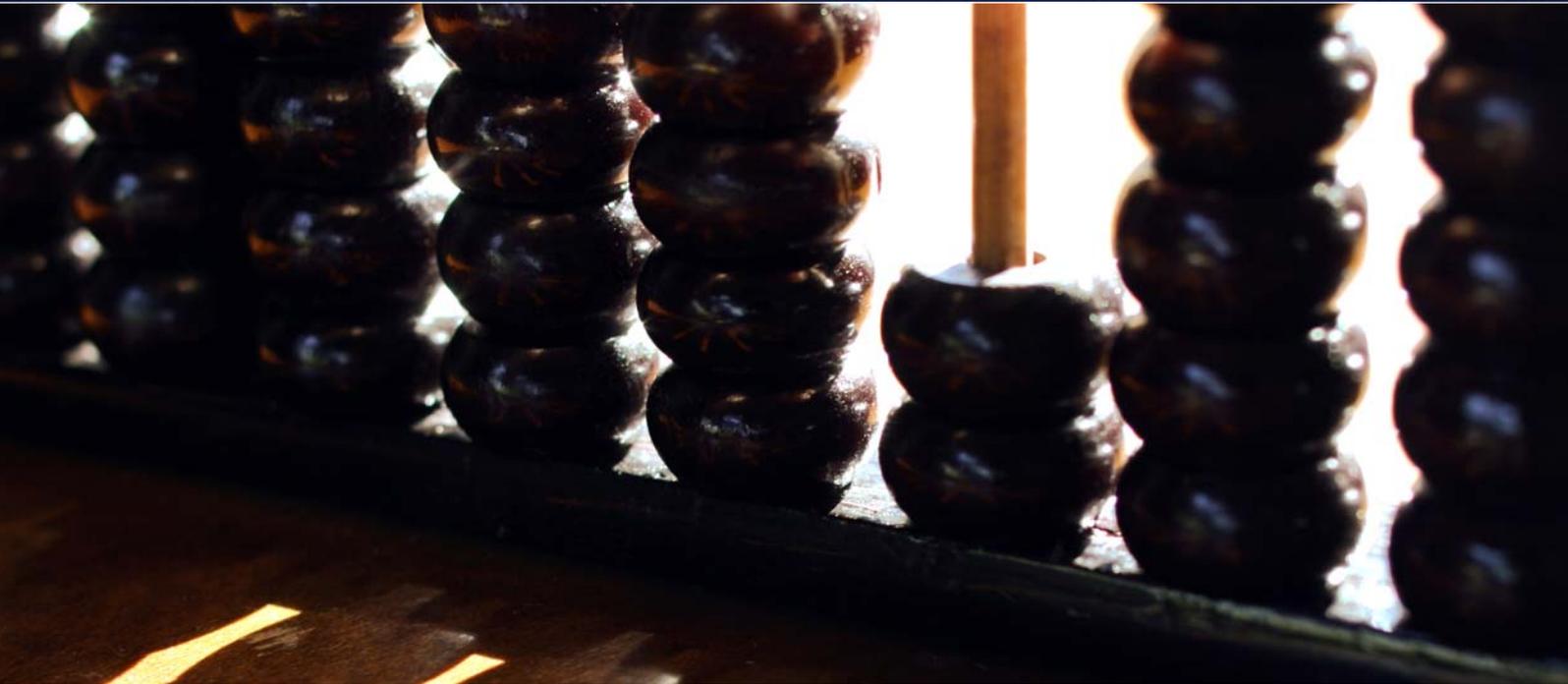




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NEW ZEALAND'S FISCAL INHERITANCE
An Assessment of the Development of Direct
Taxation in the Mother Country Part I: 1600-99

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NEW ZEALAND'S FISCAL INHERITANCE

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

PART I

1600-99

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ABSTRACT

This paper, the first in a series of four, is a brief summary of the development of British taxation during the seventeenth century. According to the literature, when New Zealand was established in 1840, the country inherited the British tax system (Hooper, et al, 1994). 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 discussion paper has 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, and the rise of a revenue administration radically altered the system of fiscal management. Furthermore, during the course of the seventeenth century, the underlying principle of tax changed, the tax base was enlarged, the method of taxation alternated between indirect and direct taxation with indirect the principle means by the end of the century. The driver of tax reform during the period was crisis; both internal and external.

JEL: N, Economic History

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

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1. INTRODUCTION

New Zealand began in 1840 as an Administered Crown Colony; a small part of the British Empire. Hooper et al (1998) describe the European experience that the first 2,000 settlers brought with them as our English heritage. However, the evolutionary details of British taxation policy are not found in the New Zealand tax history literature. The question this four Part series of discussion papers seeks to answer is the following; what was the European experience of developing fiscal policy, and of taxation in particular.

The purpose of this paper, and the three which follow², is to fill a small part of the large gap that to date authors such as Hooper et al (1998) are only able to comment on in a sentence or two.

“New Zealand inherited the British tax system and a similar capacity to resist new forms of taxation and new tax precedents”.... and, “the settlers in the new colony (arriving from 1840 onwards) were not expecting their appointed Governor –general to impose taxes which were in any way different from what they had been accustomed” (Hooper et al, 1998, pp. 17-18).

While acknowledging the contribution of 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 understanding of McKinnon (2003, p. 11) and accept 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 discussion paper, the first in the series of four, will consider the development of the British tax system during the seventeenth century; detail the process of change, and attempt to identify the drivers of seventeenth century tax reform.

A necessary requirement of scholarship is a statement of direction. Thus, there are five tentative suggestions which, accordingly, become the hypotheses for all of the papers in 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.

² This discussion paper is the first of four which focus on the Fiscal heritage of New Zealand. The intention is to begin with the years 1600-99, and then to focus on the two centuries where statistical data are available. This will enable a more qualitative assessment to also be undertaken in addition to the simply being a qualitative review. The final paper in the series turns the discussion toward the 1842 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 paper is laid out in the following manner. Section 2 contains the methodology, method and data section. Section 3 reviews the period 1600-1699, and the conclusion is Section 4.

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) 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 paper accepts the following. 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 is a summary of the seventeenth century. Part II will also be a review of the eighteenth however, the paper will also incorporate a quantitative assessment of the literatures findings. Part III, the shorter period of 1800-50 is again, both qualitative and quantitative in nature and follows the same format as Part II. This latter paper, Part III 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. Finally, in Part IV, the development of income tax will be the focus. Analysis ends in 1850, and the reason for this is that New Zealand became self governing in 1853, and thereafter, tax policy was the responsibility of the New Zealand Parliament.

The subordinate approach (method) of this paper and the three 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. For this first paper, because the seventeenth century is a period in British fiscal history when statistical data are in short supply, the work is a summary only 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). The story of our shared English heritage begins below with the Seventeenth century.

3. TAX POLICY DEVELOPMENT IN SEVENTEENTH-CENTURY ENGLAND

There are several important points to note when considering fiscal policy in seventeenth-century England. The first is constitutional crisis, an event which prompted major institutional change. Crisis preceded the Glorious Revolution of 1688 and the Bill of Rights

in 1689. Crucially, from 1688 onwards, prerogative, i.e. the right to tax, would reside with Parliament and not Royalty. In future there would be no taxation without the consent of Parliament⁵.

Irrespective of Royal or Parliamentary prerogative, the Crown's constant need for revenue, to meet expenditure, would lead to successive experiments with old but reworked forms of direct taxation to augment the unresponsive indirect taxes. In fact, the century is considered a trial period for direct tax measures. For example; in 1629 consideration was given to "a 2% levy on incomes over £125" (Sabine, 1980, p.88).

Furthermore, there was an experimentation with Ship Money in 1635 and in 1641⁶ there were poll taxes and a property tax (Slack, 2004, p. 612). There was another poll tax in 1660 and a hearth tax in 1662 (Slack, 2004). A wine dealers license in 1684 (Dowell, 1885) and an attempt to tax income, profits and bank deposits (Sabine, 1980) but, in anticipation perhaps of the nineteenth century debate over differentiation, policy deciders avoided capital. Overall there was a long-run reliance on the established forms of taxation such as subsidies, emergency assessments, head taxes, (all direct taxation); customs, and increasingly, excise taxes (indirect taxation).

The direct assessments of the period were thought the most successful because they avoided the land but not income. This was an important consideration given the construct of seventeenth century politics. Additionally, the traditional head taxes also had some success, utilising as they did an early scheduler approach to taxation. This latter method reportedly used as an index, "social position, professional status, real and personal property.... an early combination of the income and expenditure taxes that would arrive in the following century" (Sabine, 1980, p. 96).

There were also property taxes; urban tenths and rural fifteenths, which were primarily taxes on land rent. The differential supposedly reflects the respective political strengths of the landed gentry in parliament (Samson, 2002 and Douglas, 1999). Finally there was always "the faithful standby of Royalty and thereafter Cromwell" (Sabine, 1980, p. 92) customs.

None of the abovementioned tax initiatives, either individually or in combination, were totally successful in their purpose. Therefore, the Crown, as distinct from royalty or parliament was still "unable to realize a certainty of revenue" (Sabine, 1980, pp. 83-86). In any event over the century it is recorded that the real ruin of the revenue was inflation (Coffield, 1970, p. 67). Lacking the statistical data to test whether a general and sustained rise in the level of prices killed the revenue, all that might be said is; that suffering a tax base that

⁵ For historical reference; Article 4 of the *Bill of Rights, 1688* applied. The article held that the levying of money for or to the use of the crown by pretence of prerogative without grant of Parliament is illegal (Harris et al, 2004).

⁶ (Charles II, 1630-1685): King Charles's property tax, (the income tax act of 1641) was assessed on real property, personal property and public offices. (It is interesting to note that the first income tax to arrive in New Zealand was imposed on the holders of office receiving income from England i.e. Schedule E of the 1842 Income Tax Act). King Charles's tax became, over time, an inelastic rent charge that failed and did nothing to ease the Crown's indebtedness, at least in the long term and subsequently it was repealed in 1698 (Adams, 1993).

was inelastic in supply the lack of a sufficient revenue lead to an increasingly indebted Crown⁷.

The reason for an increasingly indebted Crown was that they suffered from the fiscal constraint of a voluntary tax system⁸. England during the period 1600-1699 had an under developed and often ineffective tax system, irrespective of tax type. The infrastructure of the whole tax system is reported as being questionable. “Cromwell suffered from faulty administration and thus his revenue was never optimised” (Sabine, 1980, p. 94). Daunton (2001) suggests that the government of 1671-72 went into fiscal crisis due mainly to difficulties in financial administration. Taxation, during the period was imminently avoidable and this was the problem. In essence, while the will to appropriate was there, the ability to impose effective taxation was lacking. In such an environment direct taxation was not wholly successful and indirect taxes would have to remain the norm until changes could be made.

The needed change would focus first on the administrative organisation which managed the tax system. In consequence, by the 1680's a government body was established to organise the tax collection methods (O'Brien, 2001, p. 8)⁹. Administrative initiatives such as the one mentioned were essential improvements to the tax system and O'Brien considers the seventeenth century the period when “the constitutional and administrative foundations for a fiscal state were put in place” O'Brien (2001, p. 4).

⁷ The national debt in 1697 was reported to be £16.7 million (Douglas, 1999, pg. ix). By comparison, total revenue for 1700 was £4.3 million (Kozub, 2003).

⁸ Voluntary, describes the seventeenth century taxpayer methodology then in existence and is not the concept usually attached to our understanding of indirect taxation. With an indirect tax, a person is able to decide their own tax liability according to their personal needs and wants. By electing to forego some of the goods and services which bear the tax, taxpayers can avoid taxation i.e. a taxpayer volunteers to pay or not to pay. In short “tax avoidance was in the hands of the taxpayer” (Beckett and Turner, 1990, p. 391). “In reality, taxation such as an excise tax on the necessities of life is unavoidable and can discriminate against the less well off sectors of the community. The tax is a forerunner of the expenditure taxes; it enters into the price and pushes up the cost of living. It is the easiest tax for the wealthy man and the worst for the poor” (Coffeild, 1970, p. 75).

⁹ Previously, with inefficient and ineffective collection practices, at times rather blunt methods had to be employed. For example, “troops had being used during the civil war to collect taxes” (Sabine, 1980, p. 92-93). Historically it was more usual for authorities to resort to something that was common to France but not so in England; tax farming. The task of collection was carried out according to one of three types of contract: in a rental contract for a tax farm, the tax collectors would pay a fixed rent to the government for the right to collect a tax and keep the remaining revenue; in a share contract, the government would lease the right to collect a tax to a collector for a share of the revenue; and in a wage contract, the government would pay affixed wage to its tax collectors in return for delivery of all revenue (White, 2004, p. 637). The change from tax farming via funded debt and the organisation of a revenue service and administration utilises the third method and it is this approach which became the preferred method approach during the seventeenth century and is the standard in use today. Evidence for these statements comes from Priks and White; In the mid seventeenth century England changed its system of raising revenues from tax farming, combining the granting of monopolies to direct collection within the government administration. The subsequent transfer of rent led to the improvement of England's public finances and the improvement is considered dramatic compared to the old system' (Priks, 2005, p. 1). “Britain began to abandon tax farming in the late seventeenth century; creating a highly productive bureaucracy of salaried officials” (White, 2004, p. 635).

Overall during the course of the century, 1600-99, the Crown, as distinct from Royalty or Parliament, when in search of a sufficient revenue, would arrive at a handy solution. The Crown would rely primarily on indirect taxation, attempt direct measures and thereafter, if still short of revenue the Crown would resort to the century's financial innovation, funded debt. Thus, from the end of the century funded debt would begin to heavily influence fiscal management and consequently, taxation

3. 2. Public Debt and Fiscal Purpose

The economy (management) of the State during the seventeenth century was primarily concerned with conflict and throughout the literature war is seen as a key driver of fiscal purpose. When revenue was less than adequate the resort was to either short or long-term debt and the need to repay that debt supposedly gave rise to the burden of taxation. With continual wars and the rising costs of those wars a better method was required. A method that did not overly tax the revenue, overly oppress the citizenry and one that made fiscal purpose possible.

The change was the result of a technological leap forward that can be argued did contribute to the rise of the fiscal state; funded debt, more familiarly known as the public debt. The change was the result of a financial innovation called funded debt. Regardless of the fact that funded debt shifted incidence onto future generations, funded debt also enabled a less predatory system of governance and one which met the Crown's need for a reliable and consistent revenue source. The story of how crown debt became the national debt and thereby public debt is interesting because in the centuries that followed this change, rising public debt is considered a driver of rising taxation.

Daunton (2001) suggests that the beginnings of the public debt can be traced to the government's financial need in 1665 and again in 1685; whereby, war loans were raised on the security of future tax yields. The bank of England was therefore, set up in 1694 especially to manage this public debt (Daunton 2001). Seddon informs us that the story begins in 1693 when a group of businessmen who, as a reward for services, were given a charter to open the Bank of England (Seddon, 1968). In another version that begins with taxation failing to meet the expenses of war, the financial innovations of France were seen as a method that could be used to fund the short term debt. Securities were issued and mortgaged to the revenue; thereafter, they were "only sold to subscribers in the proposed new Bank of England and if they bought half of all the issue they were to be incorporated as a bank" (Neal, 2000, p. 124).

This is considered by Seddon (1968) to be the start of a fiscal method of funded debt; that is debt where no date is set for repayment. All that is repaid is the interest and the principal is repaid when bond holders or the state chooses. This financial and fiscal innovation enabled a more successful approach to fiscal operations and enabled the Crown to better meet its need of raising a sufficient revenue irrespective of constraints. This new approach to fiscal management promoted the development of a financial intermediation sector which would ultimately give rise to a capital market for funded debt; the technological innovation which underpinned the rise of the fiscal State.

3. 3. The latter years of the Seventeenth Century

In 1689, as England went back to war with France, the need for increased expenditure meant increased taxation. The Crown initiated a monthly assessment of 5%, and then 15%; technically, and eventually a permanent land tax (Douglas, 1999). The methodology that drove this approach was; and this is in respect of the land tax of 1692 (Seddon. 1968, p. 3., and Plehn, 1902, p. 137); that “fixed property was easier to tax than moveable property”. Yet, the principal actors in the transaction, the landowning class, while consenting, rather than except other forms of taxation would behave as they had all century and practice avoidance.

With methods of direct taxes acknowledged as having failed to meet the growing needs of the treasury (Plehn, 1902, p. 136-7), the fiscal response was to rely on indirect consumption taxes. The philosophical argument by those with a voice, in the less than democratic society was, “that a man’s total expenditure was a more equitable test of his taxability [a philosophy].... supported by theorists such as Hobbes and Sir William Petty.... [two of] the most important writers on taxation before Adam Smith and [their] influence extended well into the eighteenth century” (Sabine 1980, p. 97). The shift of fiscal policy in line with this concept reinforced rather than initiated any change in the method of taxation. However, the affirmation of Parliamentary ideology demonstrates the Crowns inability to effectively tax personal incomes or effectively tax wealth.

3. 4. Economic Thought

By the turn of the century, 1700, the slowly evolving fiscal system would be underpinned by a new economic philosophy. As a matter of fiscal principle, from 1601-1699 the poor were often exempted from excessively burdensome taxation. 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). In effect, this was a breach of the previous century’s social contract. The change “was to break the long standing tradition, from the Tudor period, of exempting the poor.... [The] position [of the poor] was, [inevitably, to be] eroded by the excises” (Sabine 1980, p. 97). This was a major “change of attitude among late seventeenth-century governments on the issue of whether the poor ought to be taxed” (Beckett and Turner, 1990, p. 387).

This change in the underlying principle of taxation by the turn of the seventeenth century indicates that “fiscal policy.... [during the period] had been influenced and reshaped by financial stress and the bargaining power of narrow interest groups” (Hartwell, 1981, p. 152). Thus, the “broadening of the tax base” (Seligman, 1925, pp. 6–10), according to the new philosophy, was a dramatic change for the economy; the change represented a movement away from the ability-to-pay¹⁰ principle to a pre-utilitarian benefit principle¹¹.

¹⁰ “The *ability to pay* principle is explained by the following concept: people with a greater ability to pay taxes should therefore pay higher taxes” (Baumol and Blinder, 1979, p. 632). Additionally “the requirement that the burden of taxation should be just is very old, almost as old as the idea that just taxation is taxation according to the ability to pay and it predates the benefit principle.... To make *ability to pay* work requires an index of such i.e. how much can each person pay. In the seventeenth century the index was property. Fundamental to the ability to pay principle is that of horizontal equity (like treated alike) and vertical equity (unlike treated differently)” (Musgrave, 1959, pp. 91-95).

¹¹ “The *benefit* principle; the principle holds that people who derive the benefits from the service should pay the taxes which finance it” (Baumol and Blinder, 1979, p. 633). “The more modern form dates back to Adam Smith.... The relationship is an exchange and was accepted widely among the theorists of the seventeenth

That new philosophical approach to the application of taxation i.e. the underlying principle; would allow the burden of taxation to be shifted in accordance with what was, the financial interests of a minority of the population. The winners were the few and the losers the many. Perhaps this is not surprising as British society would remain undemocratic and unrepresentative of the poor and the middle classes for a further two hundred years.

3. 5. Summary Statement

Second-best¹² the seventeenth century tax system may have been, but during the course of the century, fiscal policy did lay the platform upon which future social and economic change would take place. The method of fiscal management, begun in the seventeenth century, was a positive step; the improved fiscal systems were also a positive step in the rise of the fiscal state and the progress of the masses towards greater representation in parliament. The fiscal initiatives of the seventeenth century, viz. the indirect tax; the beginnings of funded debt; and limited direct assessments, provided the political balance and allowed successive governments to raise the revenue needed to meet expenditure needs. By the end of the century the accepted fiscal approach would assist in creating the Empire; and, this fiscal approach would also determine the future reality for New Zealand one hundred and forty years later.

4. CONCLUSION

The story of New Zealand's English heritage is not found in the New Zealand literature and this discussion paper has been an attempt to begin to fill a small part of that gap. The paper made this an objective and, it is observable that the work has achieved its first goal. The second objective was to answer a question: What is the English experience of taxation; and, how did their tax system evolve from 1600 to 1699?

The information summarized in Section 3 has indicated, that the fiscal initiatives of the period were indirect tax; direct assessments and by the end of the century, funded debt. This approach would maintain the political balance and allow 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

century.... Taxation was the price of services rendered and seemed a natural complement to the contract theory of state. It was accepted by writers such as Hobbes and the Physiocrats.... It was also held by Locke and adopted by the eighteenth-century writers such as Hume and Rousseau.... Throughout the contract remained the basis of organised society and protection appeared as a major theme and at times the only objective of the contract. Taxes were therefore, considered a price to be paid for protection and as a membership fee for association in organised society" (Musgrave, 1959, p. 62-64).

¹² Second best refers to what is the best available policy when the true optimum (the first best) is unavailable due to constraints on policy choice. The Theory of Second Best says that a policy that would be optimal without such constraints (such as a zero tariff in a small country) may not be second-best optimal if other policy is constrained. See, Lipsey and Lancaster (1956).

accordance with a philosophical movement away from the ability to pay principle to a pre-utilitarian benefit principle.

Finally, the introduction posited five hypotheses. 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; this was then altered to the ability to pay principle. Thus, a change in 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 seventeenth century. It may be that the underlying principle of taxation is only a convenient ideology, something which assists politicians to explain policy rather than enabling *per se*, tax policy change.

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. During the course of the century the balance altered constantly and 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.

Third hypothesis, throughout recorded history, crisis is the arbiter of change. This is the interesting hypothesis because our English Heritage is strewn with the detritus of war. Throughout the British tax history literature war is presented as the arbiter of change i.e. external crisis. However, the key crisis of the 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 i.e. crisis is a key driver of tax policy development – in accordance with the literature.

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 and the paper focused attention on this aspect of seventeenth century tax evolution in Subsection 2.3, and 2.4., and therefore, this hypothesis has also being found to hold.

Fifth, 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, 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 three papers which follow in the series. This concludes Part I of a long-run investigation of our fiscal foundations – the British experience of tax policy development, 1600-1850.

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