

THE ROAD TO FREEDOM? HAYEK AND NEW ZEALAND'S TAX DEPRECIATION

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ABSTRACT

Tax depreciation provides an opportunity for governments to enact discretionary policy to promote specific social and economic goals. In the years following the Second World War a number of specific depreciation measures were enacted to supplement the general allowance in order to promote full employment and economic development. Since the market-based reforms of the 1980s, the New Zealand government has largely abandoned such measures in order to promote economic efficiency. This change reflects an underlying change in taxation philosophy.

This article interprets the development of tax depreciation in New Zealand from the perspective of the philosophical thought of Friedrich Hayek (1899–92). Hayek's writings are summarised to provide a normative basis upon which the development of New Zealand's tax depreciation is then discussed. The article contributes to the literature on New Zealand tax policy in general, and also illustrates several benefits of understanding and addressing taxation policy and policy change from a specific philosophical perspective.**

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** The author is grateful for the detailed and incisive comments provided by the anonymous referee which have resulted in significant improvements to this article.

I INTRODUCTION

Changes in taxation policy and practice indicate a lack of consensus about how best to tax. Lists of general principles of taxation, such as Adam Smith's four maxims, may be used to justify a range of divergent tax policies. Rather than focus on abstract principles, this article reviews the writings of a single author, Friedrich Hayek (1899–92), and considers how these may inform discussion of taxation policy and enhance understanding of the practice of taxation.¹ The development of tax depreciation in New Zealand's income tax legislation is used to illustrate Hayek's views.

This article extends the literature on taxation policy by detailing and applying a specific philosophical view to the discussion of taxation, and addresses calls for discussion as to what taxation policy should look like at the philosophical, and not merely the pragmatic, level.² It also extends discussion of the development of, and changes in the practice of, tax depreciation, which is an area that provides opportunities for governments to adapt taxation policy to achieve non-fiscal ends.

The article is structured as follows. The first two parts discuss Hayek's thought as he presented it in his major works, and summarise the development of New Zealand taxation. New Zealand tax depreciation history is then discussed through the lens of Hayek's thought. Part V summarises and concludes the article and suggests further avenues of research.

II HAYEK AND PLANNING

Macro-economic planning and government-led industrial policy became the norm in Western economies in the years following the Second World War, and fiscal policy played a significant part in giving effect to government policy. However, these policies were not without their critics. Among these, Friedrich Hayek warned of the danger he believed planning posed to liberty in his 1944 work entitled *The Road to Serfdom*.³ In his subsequent works *The Constitution of Liberty*⁴ and *Law Legislation and Liberty*,⁵ Hayek distinguished between a liberty sought in spontaneity and the absence of coercion, and one sought in government and collective purpose; one based on empiricism and trial and error, the other based on rationalism and prescribed pattern; one based on the Rule of Law, the other on arbitrary rules.⁶ Hayek promoted a constitutional approach — 'a higher law governing current legislation'⁷ — that limited the legislature to setting 'rules

¹ An example of this approach is Harold M Groves, *Tax Philosophers: Two Hundred Years of Thought in Great Britain and the United States* (University of Wisconsin Press, 1974).

² Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford University Press, 2002), 4 call for philosophical reflection to replace 'specious rhetoric' concerning taxation policy.

³ Hayek, *The Road to Serfdom: Text and Documents: The Definitive Edition* (Bruce Caldwell (ed)), (University of Chicago Press, 2007) (hereinafter 'RTS').

⁴ Friedrich A Hayek, *The Constitution of Liberty* (Routledge Classics, 1960) (hereinafter 'CL').

⁵ Friedrich A Hayek, *Law, Legislation and Liberty* (Routledge Classics, 1982) (hereinafter 'LLL').

⁶ RTS, above n 3, 113.

⁷ CL, above n 4, 156.

of just conduct'⁸ in order to promote human flourishing. This section outlines and illustrates aspects of Hayek's philosophy by reference to his works.

The publication of *The Road to Serfdom* brought Hayek to public attention, especially after it was condensed and distributed by *Reader's Digest*.⁹ Hayek expressed alarm that,

There exists now [in England and the United States] certainly the same determination that the organisation of the nation we have achieved for purposes of defence shall be retained for the purposes of creation.¹⁰

Hayek thought that the very anti-liberal enemy against which Britain was then fighting was now being embraced by its economic policy.¹¹ He considered economic planning to be a move towards socialism, which, though it might seem benign, would inevitably lead to slavery; he argued that 'We have progressively abandoned that freedom in economic affairs without which personal and political freedom has never existed in the past.'¹² Against this, Hayek described his position as 'liberal', in contrast to both conservatism and socialism.¹³

A Hayek on Law

1 Rules and the Rule of Law

Basic to Hayek's argument is the distinction between arbitrary rules and the Rule of Law. He commented that, 'Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law.'¹⁴

Under the Rule of Law, governments are confined to fixing general and formal rules, which Hayek referred to as 'rules of just conduct.'¹⁵ Rules of just conduct are intended to be merely instrumental in the pursuit of people's various individual ends, enabling people to predict the behaviour of those with whom they must collaborate.¹⁶ Hayek approvingly cited Lord Mansfield's (1705–93) dictum that the common law 'does not consist of particular cases, but of general principles, which are illustrated and explained by these cases.'¹⁷ In contrast, economic planning of the collectivist kind 'must provide

⁸ David Sanz Bas, 'Hayek's critique of *The General Theory*: A new view of the debate between Hayek and Keynes', (2011) 14:3 *Quarterly Journal of Austrian Economics* 288.

⁹ *Reader's Digest*, April 1945. A cartoon adaptation by General Motors was also published by *Look* magazine in 1945 <<http://mises.org/books/TRTS/>>.

¹⁰ Hayek, RTS, above n 3, 58.

¹¹ In a 1933 memorandum entitled *Nazi-Socialism*, Hayek argued that 'National Socialism is a genuine socialist movement, whose leading ideas are the final fruit of the anti-liberal tendencies which have been steadily gaining ground in Germany since the later part of the Bismarkian era' (RTS, above n 3, 245).

¹² Hayek, RTS above n 3, 67, 78.

¹³ Hayek, CL, above n 4, see especially 'Postscript: Why I am not a Conservative.'

¹⁴ Hayek, RTS, above n 3, 112, cf Harry W Jones, 'The Rule of Law and the welfare state' (1958) 58(2) *Columbia Law Journal* 143.

¹⁵ Hayek, LLL, above n 5, esp. ch 8.

¹⁶ *Ibid.*

¹⁷ *Ibid* 82, referring to *R v Bembridge* (1783) 3 Doug. 327 at 332, 99 ER 679 (KB).

for the actual needs of people as they arise and then choose deliberately between them.¹⁸ For Hayek, a liberal society is a society under law, not regulation, and law ought not to discriminate between persons.¹⁹

Non-discrimination followed from the fact of ‘the inevitable ignorance of all of us concerning a great many of the factors on which the achievement of our ends and welfare depends.’²⁰ Detailed planning by the state increases the difficulty of planning for the individual. Since the individual best knows his or her own circumstances and is thus more likely to succeed in their ends, Hayek argued that the actions of the state should be predictable, that is, ‘they must be determined by rules fixed independently of the concrete circumstances which can be neither foreseen nor taken into account beforehand: and the particular effects of such actions will be unpredictable.’²¹ Humankind must keep in mind ‘the necessary and irremediable ignorance on everyone’s part of most of the particular facts which determine the actions of all the several members of human society.’²²

2 *Evolution and Progress*

Hayek’s focus on human ignorance reflected his belief that an effective social order was not the result of conscious planning, but of social evolution.²³ For Hayek, the basic philosophical difference in social ethics was between what he termed an evolutionary, as opposed to a constructivist, rationalism.²⁴ He rejected the latter, arguing that the view that social institutions had been deliberately designed to serve human purposes was ‘rooted originally in a deeply ingrained propensity of primitive thought to interpret all regularity in phenomena anthropomorphically, as the result of the design of a thinking mind.’²⁵ In contrast, Hayek maintained that the ‘orderliness of society which greatly increased the effectiveness of individual action’ was largely due to evolution — ‘a process in which practices which had at first been adopted for other reasons, or even purely accidentally, were preserved because they enabled the group in which they had arisen to prevail over others.’²⁶ The emergence of order as the result of adaptive evolution, rather than design by either a higher supernatural intelligence or a designing human intelligence, accounted for the order evident in the world.²⁷ Anticipating the

¹⁸ Hayek, RTS, above n 3, 113.

¹⁹ Hayek distinguishes between law and legislation in LLL, above n 5, vol 1. His proposed Model Constitution proposes two legislative bodies: one responsible for ‘law’, the other for ‘legislation’.

²⁰ Hayek, CL above n 4, 27. CL ch 2 discusses this in more detail, as does LLL 12, headed ‘The permanent limitation of our factual knowledge’.

²¹ RTS, above n 3, 114.

²² Hayek, LLL, above n 5, 13.

²³ Alan O Ebenstein, *Friedrich Hayek: A Biography* (Palgrave, 2001) 151.

²⁴ Hayek, LLL, above n 5, 5. Elsewhere Hayek refers to these as an Anglican versus a Gallican view of liberty: Hayek, CL, above n 4, 49f.

²⁵ Ibid 10.

²⁶ Ibid.

²⁷ Hayek, CL, above n 4, 53. Hayek includes religious belief as one such anthropomorphical attitude. It is therefore rather surprising that some on the religious right seem quite so keen on Hayek. Based on his research into Puritan America, Valeri (2010) suggests discontinuities between the religious traditions and the economic ethics of ‘contemporary claimants to Reformed Christianity who revere capitalism’, see Mark Valeri, *Heavenly Merchandize: How Religion Shaped Commerce in Puritan America* (Princeton University Press, 2010) 249.

criticism that this was consistent with what he termed ‘the error of “Social Darwinism,”’ Hayek argued that his thesis ‘concentrated on the selection of institutions and practices rather than on the evolution of individuals, and on the selection of innate rather than on culturally transmitted capacities of the individuals.’²⁸

An implication of Hayek’s evolutionary assumption and his emphasis on human ignorance is that social and intellectual evolution is incremental and proceeds by trial and error:

As in all other fields, advance [in intellectual evolution] is achieved by our moving within an existing system of thought and endeavouring by a process of piecemeal tinkering, or ‘immanent criticism’, to make the whole more consistent both internally as well as with the facts to which the rules are applied.²⁹

In the absence of central direction, how do individuals know how to act, and how is welfare maximised? Hayek argued that prices or wages play a key role in signalling to market participants the need to change or to maintain the direction of their efforts.³⁰ However, where governments intervene, price signals are distorted by altering the relative costs of competing opportunities. As its relative cost falls due to government intervention, investment may flow into areas that would otherwise be uneconomic or unsustainable, and, conversely, otherwise preferable investments may not be made. Moreover, since an intervention is likely to have only a short-term effect and cannot account for unforeseen consequences, further intervention will be required in the future, along with a degree of coercion to achieve the intended end.

In contrast to intervention, Hayek argued that the market best serves human flourishing by increasing the chances or prospects of gaining a greater command over various goods than might be secured in any other way.³¹ In a market order, outcomes are unknown. However, what may be known are the ground rules (ie the ‘rules of just conduct’) which create a level playing field for all participants. Where these are pre-specified and change incrementally, participants in an economy are able to plan for the future. In contrast to central planning, Hayek argued that the task of such rules is ‘to tell people which expectations they can count on and which not’,³² rather than to guarantee or even promote specific outcomes.

Clear *ex ante* expectations provided by end-independent rules do not provide certainty that plans will be successful; like social institutions in general, the market is a place where the fittest survive. Rather than the *success* of all, the aim of the law should be to improve equally the *chances* of unknown persons.³³ Moreover, it is desirable that participants be permitted to succeed *or* fail for social progress to be made.³⁴ Long-term development depends upon market participants receiving clear signals so that they can alter their behaviour for their own benefit, and ultimately for the common good. Hayek summarises:

²⁸ Hayek, LLL, above n 5, 23.

²⁹ Ibid 113.

³⁰ Ibid 235.

³¹ Ibid 267.

³² Ibid 97.

³³ Ibid 288.

³⁴ Ibid ch 10.

[I]n the absence of a unified body of knowledge of all the particulars to be taken into account ... it becomes clear that the role of government in that process cannot be to determine particular results for particular individuals or groups, but only to provide certain generic conditions whose effects on the several individuals will be unpredictable.³⁵

Government policy should therefore reflect, rather than create, current social practice. In contrast to planning, the role of government is constitutive, and should promote stable ground rules rather than aim at specific ends. This results in clearer information being provided to market participants, and permits them to plan for the future without the risk that evolving social knowledge or expectations will be upset by unexpected government intervention. Indeed, Hayek argued that historically, 'The aim of constitutions has been to prevent all arbitrary action ... The test of whether a constitution achieves what constitutions are meant to do is indeed the effective prevention of arbitrariness'.³⁶

3 *The Role of Government*

Despite the limits Hayek would place on government, he was no anarchist or libertarian; he was not opposed to government or to taxation. While governments are ineffective in, if not detrimental to, the achievement of specific ends, they:

can enhance the chances that the efforts of unknown individuals towards equally unknown aims will be successful by enforcing the observance of such abstract rules of conduct as in the light of past experience appear to be the most conducive to the formation of a spontaneous order.³⁷

To achieve this, Hayek noted that it was 'unquestionable that in an advanced society government ought to use its power of raising funds by taxation to provide a number of services which for various reasons cannot be provided, or cannot be provided adequately, by the market.'³⁸ This included providing a range of services 'to preserve peace and to keep out external enemies',³⁹ as well as those services where the market is not the most effective method of provision.⁴⁰ Governments should also provide 'some security against severe deprivation'⁴¹ for 'those who for various reasons cannot make their living in the market, such as the sick, the old, the physically or mentally defective, the widows and orphans'.⁴² Coleman aptly notes that in Hayek's view:

³⁵ Ibid 178.

³⁶ Ibid 378.

³⁷ Friedrich A Hayek, 'The principles of a liberal social order' in Friedrich A Hayek, *Studies in Philosophy, Politics and Economics* (Routledge and Kegan Paul, 1967) 160, 162.

³⁸ Hayek, LLL, above n 5, 382f.

³⁹ Ibid 119.

⁴⁰ Ibid 383.

⁴¹ Ibid 294.

⁴² Ibid 395.

the state is not inert or absent; it is not the night-watchman state suggested by classical liberalism and 'market success' propositions but a *rule-bound* state; one encumbered by a constitution, and unendowed with a perpetual hunting licence to shoot 'problems'.⁴³

While governments must use coercion to raise finance (ie taxation) and have a role where the market cannot function, government provision is 'an *inferior* method of providing those services'.⁴⁴ Where the government does provide services, it must not do so 'in a manner which impairs the functioning of the spontaneous market order on which we remain dependent for many other and often more important needs',⁴⁵ for:

every step made in this direction [of growing public intervention in the market] means a transformation of more and more of the spontaneous order to society that serves the varying needs of the individuals, into an organisation which can serve only a particular set of ends determined by the majority — or increasingly, since this organization is becoming far too complex to be understood by the voters, by the bureaucracy in whose hands the administration of these means is placed.⁴⁶

B Hayek and Tax Expenditures

Specific depreciation provisions are intended by government to affect the functioning of the market by altering the cost of investment. These provisions are a type of tax expenditure, a concept coined by former United States Assistant Secretary of the Treasury for Tax Policy Stanley Surrey, and defined by him as 'those revenue losses attributable to provisions of the [...] tax laws which allow a special credit, a preferential rate of tax, or a deferral of tax liability.'⁴⁷ Tax expenditures are significantly motivated by policy goals other than revenue raising.⁴⁸

Since general depreciation rules are 'end-independent and refer only to facts which those who are to obey them can know or readily ascertain',⁴⁹ they contribute to providing a context in which an entrepreneur may plan for the future. Such rules must apply to an unknown number of future instances, where both those who create the rule and those who are subject to it are ignorant of the particular circumstances in which the rule will apply. In contrast, depreciation rules which discriminate on the basis of activity or location provide little certainty, since they could be changed at any time, being subject to administrative discretion. Moreover, such rules may protect particular

⁴³ William Coleman, 'What was "new" about neo-liberalism' (2013) 33(1) *Economic Affairs* 78 89 (emphasis in original).

⁴⁴ Hayek, LLL, above n 5, 387 (emphasis in original).

⁴⁵ Ibid.

⁴⁶ Ibid 393. Hayek refers to Wagner's Law of Growing Government expenditure, see Adolph Wagner, 'Three extracts on public finance' in Richard A Musgrave and Alan T Peacock (eds), *Classics in the Theory of Public Finance* (Macmillan, 1967) 7f.

⁴⁷ Stanley S Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Harvard University Press, 1974). While noting that, 'In practice, defining tax expenditures is difficult', the OECD proposed a definition of tax expenditures as 'provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax: OECD, *Tax Expenditures in OECD Countries* (OECD, 2010), 12.

⁴⁸ Craig Fookes, *Spending through the Tax System: Tax Expenditures* (New Zealand Treasury Policy Perspectives Paper 09/01), (New Zealand Treasury, 2009) 4.

⁴⁹ Hayek, LLL, above n 5, 205.

interests and privilege,⁵⁰ foster corruption,⁵¹ and enhance the power of pressure groups.⁵²

Whereas efficiency and equity are regarded as principles of a good tax system,⁵³ Hayek suggested that discriminatory (tax) policies such as targeted depreciation policies are likely to be both inefficient and inequitable. They are *inefficient*, since it is not possible to preserve a market order while imposing on it a particular pattern of remuneration by an authority possessing the power to enforce it.⁵⁴ Since both individuals and governments operate under a veil of ignorance,⁵⁵ it is impossible for governments to enact effective end-focused depreciation laws. Since they distort pricing signals, such laws may alter investment patterns in the short-term, but do not provide a consistent order which will encourage human innovation in the longer term. According to Hayek, 'governments notoriously fail, for reasons inherent in non-competitive bureaucratic organizations',⁵⁶ to direct investment in the most effective ways.

Discriminatory tax policies are also *inequitable*, since a government disturbs previous expectations when it enacts laws that favour one group over another. Social change and technical obsolescence may result in some taxpayers suffering failure, but such failure provides signals available to all whereby they may adapt their behaviour. Failure that results from changing conditions in circumstances open to all does not constitute injustice. As it is the essence of justice that the same principles are universally applied, 'it requires that a government assist particular groups only in conditions in which it is prepared to act on the same principle in all similar circumstances.'⁵⁷ Discrete depreciation policy which interferes with the market is thus unfair.

C Summary

Hayek summarised his 'liberal' vision of society as follows:

The central concept of liberalism is that under the enforcement of universal rules of just conduct, protecting a recognizable private domain of individuals, a spontaneous order of human activities of much greater complexity will form itself than could ever be produced by deliberate arrangement, and that in consequence the coercive activities of government should be limited to the enforcement of such rules, whatever other services government may at the same time render by administering those particular resources which have been placed at its disposal for those purposes.⁵⁸

⁵⁰ Ibid 184, 372.

⁵¹ Ibid 354.

⁵² Ibid 420, 472.

⁵³ The 2010 Tax Working Group listed efficiency and equity as the first two of six principles of a good tax system, while recognising difficulties in reconciling the two: Tax Working Group, above n 53 at 15, 55f. Okun discusses the inherent conflict between these two principles: Arthur M Okun, *Equality and Efficiency: The Big Tradeoff* (Brookings Institution, 1975).

⁵⁴ Hayek, LLL, above n 5, 232.

⁵⁵ Cf John Rawls *A Theory of Justice* (Clarendon, 1972). Hayek refers to the work of John Rawls at various points, eg LLL, above n 5 at 261, 335.

⁵⁶ Hayek, LLL, above n 5, 260.

⁵⁷ Ibid 300.

⁵⁸ Hayek, above n 37, 160 at 162.

Applied to tax policy, this suggests that governments should frame tax rules (ie the legislation itself, but also associated regulations and practice) generally, and apply them to all taxpayers indiscriminately, rather than endeavouring to favour particular taxpayers to achieve specific social or economic ends. This would provide a context in which taxpayers may then plan their activities for the long term, without fear that these ground rules will be arbitrarily changed.

Since tax depreciation policy has reflected the overall emphases of government policy in New Zealand, the following section briefly summarises the role of government in the New Zealand economy. This provides a context for the subsequent discussion of tax depreciation in light of Hayek's views.

III CONTEXT

Before the middle of the twentieth century, New Zealand's central government played an important but limited role in economic affairs, providing the night-watchman functions of internal and external security, as well as developing the country's infrastructure,⁵⁹ but offering only limited welfare provision.⁶⁰ The Depression of the 1930s, followed by the election of the First Labour Government in 1935, motivated a significant increase in government involvement in the economy.⁶¹ Contrary to the received economic wisdom, the mass unemployment of the 1930s suggested that either an economy would not reach a stage of equilibrium at full employment over time, or that the human cost of leaving the market reach equilibrium was unacceptable and so the government should intervene.⁶² The subsequent war years of 1939–45 involved a mass mobilisation of manpower and resources, and the wartime command economy became the peacetime controlled economy.⁶³

Full employment became a key goal of government economic policy following the Second World War in New Zealand and overseas.⁶⁴ The Industrial Development

⁵⁹ For example, during the 1870s, Premier Julius Vogel borrowed significant sums from overseas to enhance New Zealand's infrastructure: Raewyn Dalziel, 'Vogel, Julius 1835–1899', in *Dictionary of New Zealand Biography* (Ministry for Culture and Heritage, 2007) <<http://www.dnzb.govt.nz>>.

⁶⁰ David Thomson, *A World without Welfare: New Zealand's Colonial Experiment* (Auckland University Press, 1998) described Colonial New Zealand as 'a world without welfare'. Similarly, Margaret McClure, *A Civilised Community: A History of Social Security in New Zealand 1898-1998* (Auckland University Press, 1998), 6 described welfare provision in New Zealand prior to the passage of *Social Security Act 1938* as 'niggardly'.

⁶¹ For an overview of the period refer Gary Hawke, 'Economic trends and economic policy, 1938-1992', in Geoffrey W Rice (ed) *The Oxford History of New Zealand* (Oxford University Press, 1992) 412. A similar trend was evident in Britain: see Jim Tomlinson, 'Managing the economy, managing the people: Britain c. 1931-70' (2005) 58(3) *Economic History Review* 555. Tomlinson suggests that the role of the British State's fighting of a 'total war' during the First World War presaged the shift to a managed economy in Great Britain. This shift was confirmed by the needs of the Great Depression and the Second World War.

⁶² Nicholas Wapshott, *Keynes Hayek: The Clash that Defined Modern Economics* (Norton, 2011) 31.

⁶³ Gary R Hawke, *The Making of New Zealand: An Economic History* (Cambridge University Press, 1985), 163 refers to New Zealand's 'controlled economy, from 1938 to 1968 and after.'

⁶⁴ See Monica Prasad, *The Politics of Free Markets: The Rise of Neoliberal Economic Policies in Britain, France, Germany, and the United States* (Chicago: University of Chicago Press, 2006) 2; Alan Booth 'The "Keynesian" revolution in economic policy-making' (1983) 36(1) *Economic History Review* 103; Jim Tomlinson, "'Decline": The falling behind of the British economy in the post-war years' (1996)

Conference held in Wellington in 1960 specifically 'endorsed the policy of full employment which is included in the full use of all resources.'⁶⁵ The Conference noted that 'the basic aim in New Zealand's monetary and fiscal policy should be the maintenance of full employment, high and rising living standards, and the economic development of all resources, coupled with sufficient restraints to ensure reasonable stability in costs and prices.'⁶⁶ To this end, the Conference endorsed an increased role for the government in providing incentives to industry,⁶⁷ including an enhanced use of tax provisions such as the accelerated writing off of capital costs⁶⁸ and regional incentives.⁶⁹

The post-war extension of the role of government intervention in the economy is popularly referred to as Keynesianism,⁷⁰ after the British economist John Maynard Keynes (1883–1946). In his 1936 magnum opus, *The General Theory of Employment, Interest and Money*, Keynes had advised that 'the central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government.'⁷¹ As regards investment, Keynes concluded that, 'we must recognise that only experience can show how far the common will, embodied in the policy of the state, ought to be directed to increasing and supplementing the inducement to invest'.⁷² Keynes's economic views were popularised by Paul A Samuelson in the successive editions of his textbook, *Economics*.⁷³

New Zealand's 'Keynesian'⁷⁴ post-war settlement⁷⁵ ended after 1984 following the election of New Zealand's Fourth Labour Government,⁷⁶ which adopted a range of market-based economic policies. Rankin commented that, since 1984 the New Zealand

49(4) *Economic History Review* 731; Hugh Dalton, *Principles of Public Finance* (4th ed, Routledge and Kegan Paul, 1954), Margaret Weir, 'Ideas and politics: The acceptance of Keynesianism in Britain and the United States', in Peter A Hall (ed) *The Political Power of Economic Ideas: Keynesianism across Nations* (Princeton University Press, 1989) 53.

⁶⁵ Industrial Development Conference, *Report: Industrial Development Conference, June 1960* (Government Printer, 1960) 79.

⁶⁶ *Ibid* 143.

⁶⁷ *Ibid* 89.

⁶⁸ *Ibid* 147.

⁶⁹ *Ibid* 121.

⁷⁰ McAloon comments that 'Keynesianism is a convenient shorthand term for a broad and general approach to economic policy, and inevitably the use of shorthand obscures more than it explains unless definitions are made clear': Jim McAloon, *Judgements of All Kinds* (Victoria University Press, 2013), 21. Since this article focuses on Hayek and not Keynes, it provides only a limited discussion of Keynes to provide context.

⁷¹ John Maynard Keynes, *The General Theory of Employment, Interest and Money* (BN Publishing, 2008), 237.

⁷² *Ibid* 235.

⁷³ Robert H Nelson, *Economics as Religion; From Samuelson to Chicago and Beyond* (Pennsylvania State University Press, 2001), 34: 'Samuelson's *Economics* would be the means by which the Keynesian gospel was communicated to millions of American college students in the post-war years'.

⁷⁴ The label 'Keynesian' obscures as much as it reveals, since 'the Keynesian tradition has always encompassed a broad range of individual positions': Bryan S Roper, 'Neo-liberalism: A radical critique' in Raymond Miller (ed), *New Zealand Government and Politics* (Oxford University Press, 1985) 578, 585.

⁷⁵ McAloon, above n 70, 21.

⁷⁶ *Ibid* ch 9.

economy took a 'diametrically opposite direction from the 1938 to 1975 strategies.'⁷⁷ According to Evans et al, 'the key theme of the macroeconomic approach of both the monetary and fiscal authorities through the [post-1984] reform period has been to provide stable policies rather than stabilisation policies.'⁷⁸

IV HAYEK AND THE DEVELOPMENT OF TAX DEPRECIATION IN NEW ZEALAND

Hayek argued that his views were consistent with nineteenth-century liberalism; however, following the Second World War and prior to the economic crises of the 1970s, Hayek, like other critics of planning, was 'far out of the field of vision of mainstream scholars'.⁷⁹ While 'Keynesian' approaches dominated policy in democratic states after 1945, Hayek's prescriptions, if not his philosophy,⁸⁰ became evident in the economic policy of many Western countries from the late twentieth century. Hayek's ideas were known in New Zealand in the 1940s and became evident in policy after 1984.⁸¹

Hayek's writings provide a means to make sense of New Zealand's economic and taxation history. However, rather than discuss the whole economy, this section focuses on a smaller domain to provide an insight into the development of an economy and its taxation. Tax depreciation provides a context in which to discuss these changes in tax policy. Three distinct phases may be discerned in the development of tax depreciation in the New Zealand income tax, and these are discussed sequentially.

⁷⁷ Keith Rankin, 'Ideas for New Zealand Industry' in Rodin Genoff and Roy Green, *Manufacturing Prosperity: Ideas for Industry, Technology and Employment*, (Federation Press, 1998), 211.

⁷⁸ Lewis Evans, Arthur Grimes, Bryce Wilkinson, and David Teece, (1996), 'Economic reform in New Zealand 1984-95: The pursuit of efficiency' (1996) 34 *Journal of Economic Literature*, 1856, 1863.

⁷⁹ Prasad, above n 64, 2 notes that 'in 1967 Eric Hobsbawm called Hayek — correctly — a "prophet in the wilderness"'.
⁸⁰ Ibid 21.

⁸¹ Jim McAloon, above n 70 at 9, 28, 82; see also Roper, above n 74. Despite this, Hayek's name was rarely invoked and the extent of *direct* influence may be questioned. Don Brash, the Reserve Bank Governor from 1988, noted that his own shift from Keynesianism and Fabian socialism was based not on Hayek's writings (which he had not read) but on observation: Donald T Brash, *New Zealand's Remarkable Reforms; Fifth Annual Hayek Research Lecture* <http://www.rbnz.govt.nz/research_and_publications/speeches_/1996/0031201.html>. Nor is it evident from his writings that Roger Douglas, the Labour Minister of Finance responsible for New Zealand's pro-market reforms of the 1980s, had done so. Rather, his views and policy developed over the years, shifting from interventionist and regulatory policies to the market. James comments that Douglas did not promote his policy approach 'out of an ideological belief in the market or individual freedom, but because he saw it was a practical means to generate greater wealth and welfare, given what he saw as the rigidities of centrally planned and controlled economic management and its consequent failure to generate growth. Rogernomics was liberal in content rather than libertarian, practical, rather than doctrinal': Colin James, 'Overview', in Simon Walker, *Rogernomics: Reshaping New Zealand's Economy* (Centre for Independent Studies, 1989) 11. In contrast, two Ministers in the subsequent National Government (1990–99), Ruth Richardson (Minister of Finance) and Simon Upton, were both members of the Mont Pelerin Society, see Ruth Richardson (1995), *Making a Difference* (Shoal Bay Press, 1995); Simon Upton, *The Withering of the State* (Allen and Unwin, 1987).

A From 1894 to the End of the Second World War

New Zealand's first successful income tax was enacted in 1891.⁸² While the legislation differed from its British progenitor in several respects, New Zealand inherited the common law, and British precedent applied in New Zealand. Since the common law applied unless overridden by statute, New Zealand's initial 1891 income tax legislation was short and provided little detail. In particular, the original Act made no mention of depreciation. A strict application of the capital/revenue distinction would mean that no depreciation should be allowed against assessable income, since 'the allowance for depreciation is an allowance in respect of exhausted capital, hence in the absence of express provision in the Act, no allowance could be made to cover the loss arising therefrom.'⁸³ In fact, there was no need to legislate for depreciation since it was common commercial practice to allow for depreciation in the determination of profits, and it 'was already the practice of the Commissioner and the accounting profession at that time ... to deduct from income a sinking fund for the replacement of assets.'⁸⁴ The common law allows for adaptation to changing circumstances.

Parliament subsequently amended the 1891 Act in 1894 by adding a proviso to Schedule F of the Act. This specifically permitted the Commissioner to allow a deduction for depreciation on 'any implements, utensils, or machinery as he may consider just in respect of the diminished value during any year by reason of fair wear and tear' that did not result from obsolescence or could not be made good by repair.⁸⁵

This provision was subsequently amended in 1900 to permit a deduction for an asset that had become obsolete or useless.⁸⁶ A deduction for the depreciation of buildings was finally permitted in 1917.⁸⁷ The previous disallowance of building depreciation may reflect the legacy of the capital/revenue distinction, since land and buildings are capital assets par excellence. The Commissioner's ability to recover depreciation on the sale of an asset was confirmed in 1920.⁸⁸ Even after these amendments, until 1945 there was a single section in the Act pertaining to depreciation.

Although the depreciation regime operated at the Commissioner's discretion, the Commissioner published allowable rates of depreciation for classes of assets in broad bands which applied to all taxpayers. Distinctions in rates reflected differences in the actual reduction in value of the asset itself or the circumstances in which it was used, and so provided an approximation of the actual (ie economic) depreciation of the asset. Moreover, the rates changed infrequently.

The 1924 Royal Commission into Land and Income Taxation in New Zealand confirmed the expectation that depreciation, like taxation itself, should be subject to general rules, noting that:

⁸² *Land and Income Assessment Act 1891*.

⁸³ H A Cunningham, *Land and Income Tax Law in New Zealand* (Butterworth, 1933) [397].

⁸⁴ Valabh Committee, *Tax Accounting Issues* (New Zealand Consultative Committee on the Taxation of Income from Capital, 1991) [8.4.1].

⁸⁵ *Land and Income Assessment Acts Amendment Act 1894* s 18.

⁸⁶ *Land and Income Assessment Act 1900* s 66(1).

⁸⁷ *Finance Act 1917* s 30.

⁸⁸ *Land and Income Tax Amendment Act 1920* s 17.

The base on which income-tax revenue is raised should be made as broad as possible in order to lighten the weight of the tax. Every decision to free from tax, or tax lightly, some source of income carries with it a decision to tax some other source at a higher rate than would otherwise be necessary.⁸⁹

This suggests a broad-base, low-rate basis of income tax and an aversion to discretionary policy. The Commission did recommend that ‘a more reasonable allowance be made for depreciation of certain assets used in sawmilling and mining ventures’,⁹⁰ but this was not in order to favour these industries, but rather on the grounds that the existing allowance did not reflect economic reality, and in fact discriminated against these industries.

Prior to the Second World War, New Zealand’s depreciation policy was largely consistent with what Hayek referred to as ‘liberalism’,⁹¹ namely, the preference of universal over particular rules, and an aversion to end-focussed rules. The depreciation provision in the income tax legislation was short and simple, and was intended to apply indiscriminately to all taxpayers. Rather than being an imposed novelty, it reflected and was informed by evolving commercial practice. Since asset classifications were broadly defined, and the rates themselves changed infrequently, the Act provided a degree of certainty to taxpayers so that they could make plans based on an expectation that the effect of tax depreciation on the cost of investment was not likely to change in the foreseeable future; that is, the government would not capriciously alter long-standing policy or distort price signals and thereby frustrate business plans. Nor was there an indication that depreciation policy was intended to achieve any particular ends aside from setting the general rules for income taxation.

B From the Second World War to 1984

Economic policy responded to crisis. To prevent a recurrence of the depredations of the Great Depression of the 1930s, the government pursued a policy of full employment, and the experience of planning and control for the Second World War provided a pattern that was followed into peacetime.⁹² Policy shifts at the macro level were reflected in changes to depreciation policy at the micro level. This was evident in the report of the 1951 Taxation Committee which now included as purposes of taxation, ‘the protection of industries or control of spending’, and ‘the promotion of employment.’⁹³

A policy of ‘planned capitalism’ was pursued in the ensuing decades — ‘a curious blend of communitarian Christian ethics with the individualism and belief in progress of the Enlightenment’.⁹⁴ Taxation policy was critical to the success of this pursuit. Tax revenue,

⁸⁹ WA Sim, ‘Report of the Royal Commission appointed to inquire into the subject of land and income taxation in New Zealand’ (1924) I AJHR B-5 [5].

⁹⁰ Ibid [8u].

⁹¹ Hayek discusses his unease with the term ‘Liberal’ and discusses his understanding of the term in his postscript to CL above n 4 entitled ‘Why I am not a conservative.’

⁹² Hawke, above n 63.

⁹³ Tony N Gibbs, ‘Report of the Taxation Committee’ (1951) I AJHR B-8 [60].

⁹⁴ Prasad, above n 64, 2.

which had reached record levels during the war, was maintained at high levels after the war, as the welfare state, introduced in 1938,⁹⁵ was implemented.⁹⁶

Throughout this period, the basic depreciation provision in the *Income Tax Act* remained largely unchanged. However, from 1945 a number of additional sections supplemented this provision. As a result, New Zealand had a 'dual system' of depreciation;⁹⁷ while the basic depreciation rules remained largely unchanged from those enacted in 1894, specific provisions were enacted to further the government's economic and social policies. Two such measures were accelerated depreciation introduced in 1945 by the Labour Government, and investment allowances introduced in 1963 by the National Government. Intervention in the economy enjoyed cross-party support.

1 *Accelerated Depreciation*

The Labour Government's 1945 Budget was delivered following Victory in Europe (May 1945), and with Victory over Japan (August 1945) anticipated. In his budget, the Minister of Finance noted that 'the Government's policy is one of full employment.'⁹⁸ This policy would enhance purchasing power, but 'it cannot be too strongly emphasized that the standard of living depends upon the volume of goods produced and services made available.'⁹⁹ The Minister confirmed that the predominant objective in the government's post-war activities must be to encourage a rapid expansion of production. Not only did the budget set out the objective of policy, it also indicated that the government would actively promote policies to achieve it.

Accelerated depreciation was a means to this end, and permitted a taxpayer to claim additional depreciation on certain assets beyond scheduled rates during the first five years of a specified asset's life. The policy was intentionally end-focused; the Minister of Finance advised that the purpose of accelerated depreciation was:

to encourage manufacturers and others to buy new plant; to demolish old buildings, to demolish unscientifically lit buildings, and even to scrap plant that has only been operating a few years, if they can see new machinery that would do the job more economically.¹⁰⁰

This measure could affect investment decisions in several ways. Since the measure initially applied for only a three year period (but was subsequently extended), it might encourage businesses to bring forward their investment plans to take advantage of the provision. It altered the relative returns of new as opposed to existing plant, resulting in a changed allocation of resources by businesses, or an inefficient scrapping of perfectly serviceable assets. It also discriminated between taxpayers, since the provision applied to certain assets only. Moreover, as with depreciation generally, accelerated depreciation was at the discretion of the Commissioner. Not only did this create a lot of

⁹⁵ *Social Security Act 1938*.

⁹⁶ See Rob Vosslander, 'How much? Taxation on New Zealanders' employment income 1893–1984' (2009) 15(4) *New Zealand Journal of Taxation Law and Policy* 299.

⁹⁷ Gibbs, above n 93 [284].

⁹⁸ (9 August 1945) 269 NZPD 114.

⁹⁹ *Ibid*.

¹⁰⁰ (3 December 1945) 272 NZPD 289f.

paperwork, it reduced certainty, which is a hallmark of not only a good tax system, but also of the Rule of Law.

Accelerated depreciation was extended to a larger range of assets and businesses before it was repealed in the 1990s, including plant, machinery, or equipment or employee accommodation provided for the purpose of any farming or agricultural business in New Zealand,¹⁰¹ and worker's accommodation other than for farming or agricultural employees.¹⁰² Moreover, both the rates and the extent of accelerated depreciation were subject to frequent adjustment.

2 *Investment Allowances*

Like his Labour counterpart, National's Minister of Finance accepted the government's role in steering the economy. The objective of his 1963 budget was 'to provide the added incentives which will help to accelerate New Zealand's progress — incentives for development, for production, for exporting.'¹⁰³ In the Minister's view, 'investment in both industrial and agricultural plant and equipment is not large enough.'¹⁰⁴ This justified a series of tax concessions to agricultural and industrial producers. The government introduced investment allowances to promote investment in particular regions or industries by permitting an upfront deduction of a percentage of the cost in addition to ordinary depreciation. In effect, a taxpayer could deduct more than 100 per cent of the cost base of an asset over its life.¹⁰⁵

Investment allowances initially applied only to new manufacturing and agricultural plant and machinery, and to investments in redevelopment projects on the economically depressed West Coast. As with accelerated depreciation, investment allowances were intentionally end-focused. This was recognised by the government a decade later, which advised that:

the present broad range of first year depreciation allowances on plant and machinery should be replaced by a more selective system of incentives designed to emphasise both export production and regional development, and to encourage industries to plan their development in a co-ordinated fashion.¹⁰⁶

Accelerated depreciation and investment allowances supplemented ordinary depreciation with measures that were intended to alter taxpayer behaviour. Rather than leaving it to the market, via the price system, to inform decision-making, these measures were aimed at achieving or promoting particular outcomes by altering the incentives (ie

¹⁰¹ *Land and Income Tax Amendment Act (No. 2) 1950* s 8.

¹⁰² *Land and Income Tax Amendment Act 1953* s 12.

¹⁰³ (11 July 1963) 335 NZPD 501.

¹⁰⁴ *Ibid* 505.

¹⁰⁵ Simcock advised that Investment Allowances 'are not to be confused with depreciation which may fairly be described as an allowance which takes regard of the wear and tear, obsolescence factor and other items associated with the use of plant and other assets in a business': J Simcock, 'Tax notes — 1963 budget proposals' (1963) 42(2) *Accountants Journal* 65 66. However, accelerated depreciation and investment allowances have a similar effect in accelerating the speed with which a business can claim the cost of capital investments against its tax liability.

¹⁰⁶ Cited in Charles A Staples, *A Guide to New Zealand Income Tax Practice 1976/77* (Sweet and Maxwell, 37th edition, 1976) [693].

the pricing information) available to taxpayers. Moreover, unlike general depreciation, these measures were subject to change, and, in contrast to the general depreciation provisions, the legislation was described as ‘rather long and somewhat complicated.’¹⁰⁷

While special depreciation and investment allowances remained until the early 1990s, the 1967 Taxation Review Committee noted that these allowances ‘discriminate between taxpayers and between particular kinds of investment and as a result distortions are introduced into the economy. Tax concessions of this nature are also open to criticism on the grounds of equity.’¹⁰⁸ Hayek would agree. However, the Committee concluded that these allowances should continue at the discretion of the Minister of Finance where an ‘approved project was deemed to be in the national interest.’¹⁰⁹

3 Summary

Like other selective depreciation measures, accelerated depreciation and investment allowances contrast with Hayek’s views. These measures were discriminatory, favouring particular taxpayers over others, and potentially led to an inefficient allocation of resources and the favouring of special interests. Rather than reflect and promote spontaneous activity, they were imposed at the whim of the government. Frequent amendments to such policies (eg by adjusting eligibility criteria or rates) could lead to short-term rather than long-term planning and hinder innovation. Overall, such policies were end-focused, and thus uncertain to succeed, since in the absence of perfect knowledge it is impossible to plan on the basis of uncertain ends. These measures evince the planning focus of the post-war years, which, Hayek had argued, was a road to serfdom.

Moreover, as measures of end-focused law-making, these measures contrasted with the general depreciation provision which, like the common law, was end-independent. There was a shift in tax law policy from general principles accepted by all, to discretionary law in which ‘the accent is heavily on incentives which are designed by the Government in terms of its policy to increase production in New Zealand and to increase export receipts,’¹¹⁰ and which applied to (and favoured) only some. While the Opposition Labour Party ‘support[ed] incentives and believe[d] they are a good thing, particularly in relation to exports,’¹¹¹ its Finance Spokesperson expressed the concern that:

The incentives provided in the Bill take us further away from some of the established canons of taxation ... the canons of equity, certainty, convenience, and economy. Some of the provisions of this Bill are contrary to these canons, although I know it is difficult, in trying to provide an incentive for a special group, to adhere strictly to them.¹¹²

¹⁰⁷ (18 October 1963) 337 NZPD 2604.

¹⁰⁸ L N Ross, *Taxation in New Zealand: Report of the Taxation Review Committee*. (New Zealand Government Printer, 1967), [631].

¹⁰⁹ *Ibid* [634].

¹¹⁰ (18 October 1963) 337 NZPD 2603.

¹¹¹ *Ibid* 2607.

¹¹² *Ibid*.

The New Zealand Parliament was prepared to supplement, if not supplant, almost two centuries of generally accepted principle to achieve pragmatic goals.

C After 1984

Before the 1984 General Election, Robert Muldoon had been both the National Party Prime Minister and the Minister of Finance for nine years. Muldoon was not averse to intervention. After losing power, he wrote disparagingly of the economic reforms of the subsequent Fourth Labour Government (1984–90), commenting that:

intervention by the government in the economy was a normal procedure in New Zealand as it is and has been in every country around the world. The whole concept of government is based on intervention ... Intervention is what government is about, and in a democracy it is the people who decide whether that intervention is acceptable and if they say, 'No, it is not,' then they proceed to change the government.¹¹³

Muldoon's view contrasted starkly with the policies adopted by his successors.

Like the First Labour Government elected in 1935, the Fourth Labour Government introduced radical reforms. New Zealand was economically challenged: Britain's joining the Common Market in 1973, two oil shocks, the breakdown of the Bretton Woods agreement, and stagflation had contributed to the end of post-war prosperity. Domestic economic policy included high inflation to offset wage growth; high marginal tax rates; price, wage and interest rate freezes; and direct investment by the government in a range of ill-fated 'Think Big' projects in the early 1980s in an attempt to promote import substitution and economic growth, diversify the New Zealand economy, and offset rising unemployment.¹¹⁴

While Muldoon was still in office, the 1982 McCaw Committee had expressed concern as to the benefits of tax expenditures, urging that these be subject to more explicit accounting, and recommended 'that the Government should undertake without delay a rigorous assessment of major tax incentives to ascertain whether or not their continued (and uncertain) cost can be justified relative to the benefits.'¹¹⁵ This reflected a concern already alluded to by the 1967 Taxation Review Committee.¹¹⁶

In its briefing to the incoming Labour Government after the 1984 General Election, the New Zealand Treasury argued that, 'The New Zealand tax system is unsatisfactory in many respects.'¹¹⁷ In particular, 'many of its features are contrary to any reasonable efficiency and equity criteria. Rectification of these defects will require significant structural changes.'¹¹⁸ In respect of taxation incentives, Treasury sounded a Hayekian note:

¹¹³ Robert D Muldoon, *The New Zealand Economy: A Personal View* (Endeavour Press, 2005) 119.

¹¹⁴ See further Barry Gustafson, *His Way: A Biography of Robert Muldoon* (Auckland University Press, 2000) 277-89.

¹¹⁵ Peter M McCaw, *Report of the Task Force on Tax Reform* (Government Printer, 1982) [4.18].

¹¹⁶ Ross, above n 108, ch 41.

¹¹⁷ Treasury, *Economic Management* (1984), 210.

¹¹⁸ *Ibid.*

industry specific tax concessions, incentives and exemptions alter relative pre- and post-tax rates of return and distort investment choices. For example, investment allowances discriminate arbitrarily between different types of asset ... To achieve efficiency, the tax system should be neutral with respect to business decisions, such as investment choices¹¹⁹

Treasury identified accelerated depreciation measures and investment allowances as tax expenditures and noted that, 'Frequently the tax system is a very poor method of targeting assistance, assuming that assistance is justified in the first place.'¹²⁰ From the 1980s governments undertook substantial tax reforms to broaden the tax base and lower tax rates.¹²¹ Depreciation was not exempted from these reforms. In particular, both accelerated depreciation¹²² and investment allowances¹²³ were phased out in the early 1990s.

In 1993 the government significantly reformed the depreciation provisions in the *Income Tax Act*. While these reforms were largely administrative, they also introduced the concept of 'economic rates of depreciation',¹²⁴ signalling that depreciation was but one business deduction among many and should be allowed on the same basis. This was consistent with the recommendation of the 1991 Valabh Committee that the criteria that the Commissioner applied when determining rates of depreciation be explicitly stated.¹²⁵ *Ex ante* and non-discriminatory rules replaced arbitrary and discriminatory policy.

The depreciation rules were further reformed following the release of the report of the Tax Working Group in 2010, which noted that 'New Zealand's tax depreciation rates ... are higher than economic depreciation rates. This tends to bias investments into certain depreciable personal property and creates capital allocation distortions.'¹²⁶ In particular, a 20 per cent loading on depreciation rates was 'distorting investment decisions and the neutrality of the tax system would be improved by removing it.'¹²⁷ The government removed the loading,¹²⁸ and also disallowed a depreciation deduction on buildings with an estimated useful life of 50 years or more, as neither provision reflected economic reality.¹²⁹

According to the Tax Working Group, a good tax system should, inter alia, 'minimise the harm it does to growth', and 'minimise distortions to investment allocation decisions'.¹³⁰ The current broad-base, low-rate focus of New Zealand tax policy¹³¹ contrasts with the

¹¹⁹ Ibid 220.

¹²⁰ Ibid 227.

¹²¹ Maples provides a list of the tax reforms undertaken since 1984: see Andrew Maples, 'The history of taxation' in Rob Vosslamber (ed), *New Zealand Taxation 2013: Principles, Cases and Questions* (Thomson Reuters, 2013) [2.2.8].

¹²² *Income Tax Amendment Act 1993* s 27(b).

¹²³ *Income Tax Amendment Act (No 2) 1990* s 63.

¹²⁴ Inserted by *Income Tax Amendment Act 1993* s 2(1), currently *Income Tax Act 2007* ss EE 26ff.

¹²⁵ Valabh, above n 84 [8.6.3].

¹²⁶ Tax Working Group, above n 53, 54.

¹²⁷ Ibid.

¹²⁸ *Taxation (Budget Measures) Act 2010* s 77.

¹²⁹ Ibid s 81.

¹³⁰ Tax Working Group, above n 53, 59.

¹³¹ Ibid 14.

approach evident in depreciation policy in the decades following the Second World War. New Zealand returned to a single system of tax depreciation, intended to reflect the economic loss in the value of an asset.¹³² In contrast to overseas jurisdictions, few incentives remain.¹³³ The 2001 Tax Review had already indicated the extent of change in tax philosophy in New Zealand:

The current system developed over the years since McCaw [1982] represents the broad-base, low-rate model. The [previous] system represents the narrow-base, high-rate model. ... we do not think there is any support for paying for such concessions by reintroducing the pre-1988 tax scale with individual rates up to 48 per cent.¹³⁴

Since 1984, New Zealand tax depreciation policy has increasingly removed post-war end-focused depreciation policies. The current (2007) *Income Tax Act* provides a general depreciation policy which applies to all, rather than discrete policies that discriminate between taxpayers. Changes to allowable rates should be justified on economic rather than policy grounds and reflect economic reality, rather than the preferred outcomes of the government. Rather than engaging in game-playing, or suffering frustration of their expectations, depreciation policy is intended to assist taxpayers in planning for the future. While the outcome of a business venture will always be uncertain, one aspect of uncertainty — arbitrary government policy — is mitigated when general rather than specific provisions are in force and change slowly. Moreover, depreciation policy is set *ex ante*, and the permitted depreciation is end-independent; as long as the expenditure on assets meets the general deductibility provision of the *Income Tax Act*, depreciation may be claimed irrespective of the type of activity in which the asset is used.

V DISCUSSION AND CONCLUSION

The shift from a single system of depreciation that reflected a shift from extant commercial practice prior to the Second World War, to an ends-focused policy following that War, and then back towards a means-based approach after 1984, is indicative of broader changes in New Zealand society. Indeed, in the modern world, taxation reflects the social contract.¹³⁵ Moreover, tax depreciation provides a case study of the effects of two contrasting policy perspectives on taxation policy: a principles-based approach as advocated by Hayek, and a pragmatic, goal-focused approach. In general terms, tax depreciation policy in New Zealand reflected the former until 1945, the latter until the mid-1980s, and since then has again increasingly conformed to the former.

¹³² *Income Tax Act 2007* s EE 30 provides a formula for calculating economic rates of depreciation, which is based on the residual value and estimated life of the asset.

¹³³ The 2013 Tax Expenditure Statement lists several tax expenditures where taxation may be deferred, including in the forestry, film and mining industries, see Treasury, 2013 Tax Expenditure Statement (Treasury, 2013) <<http://www.treasury.govt.nz/budget/2013/taxexpenditure>>.

¹³⁴ Robert McLeod, David Patterson, Shirley Jones, Srikanta Chatterjee, and Edward Sieper *Tax Review 2001: Final Report*, (Wellington: New Zealand Treasury, 2001) [1.44f].

¹³⁵ Isaac W Martin, Ajay K Mehrotra and Monica Prasad, 'The thunder of history: The origins and development of the New Fiscal Sociology' in Isaac W Martin, Ajay K Mehrotra and Monica Prasad, *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective* (Cambridge University Press, 2009) 1.

Several implications may be drawn. First, ideas matter. Both the shift to planning and incentives following the Second World War, and the shift back to the market after 1984, reflect a philosophical basis. Even if Hayek or his opponents were not mentioned by name and their works were not read by politicians and officials, their ideas affected policy. The broad-base, low-rate approach to tax policy has theoretical underpinnings which could provide a more explicit 'conceptual framework'¹³⁶ for taxation policy development. An appreciation of contrasting philosophical approaches leading to an understanding of tax history should enhance understanding, criticism and improvement of tax policy.

Secondly, context matters. The shift towards planning was a means to achieve full employment, and this policy goal was itself a consequence of the unacceptable deprivations of the Great Depression and the experience of an economy shifting from the controlled wartime economy. Likewise, the later shift from intervention was in part a reaction against the failings of this post-war policy in a changing world where inflation and unemployment seemed untameable. An understanding of taxation policy requires an interdisciplinary context, such as that advocated by proponents of the New Fiscal Sociology,¹³⁷ to help clarify why particular ideas and hence policies are adopted.

Ideas and context affect tax policy; yet there is a lack of discussion of the philosophy of taxation. While contested, taxation is largely taken for granted. Murphy and Nagel lamented the gap or at least under-populated area in philosophical discussion of the ethical dimensions of public policy.¹³⁸ This is also true of tax policy in general. While explicit statements of tax philosophy might be castigated as 'ideological', all policy reflects a tacit or latent ideology. Viewing policy through the perspective provided by a particular author provides a lens the better by which to understand the policy — irrespective of whether one agrees with the author or not. An appreciation of philosophy — Hayek's or another's — may enhance our understanding of taxation policy.

Finally, Hayek and other philosophers provide a means to introduce philosophy into the teaching of taxation, and to extend the focus of tax teaching from the 'how?' of taxation to questions of 'why?' and 'what if?' This may prepare students to evaluate taxation as socially constructed and contestable, rather than as a given to be complied with or avoided, and better equip them to evaluate and critique policy.

A Further Research

This article is based on one country, one philosopher and a limited range of archival sources. Further research could extend each of these areas. Given that a number of Western nations, including the United States of America under President Reagan, and the United Kingdom under Prime Minister Thatcher, followed a similar interventionist path after the Second World War and a neo-liberal path after 1980, international

¹³⁶ Geoffrey W Lewis, 'Comments on the Task Force Report on Tax Reform', (1982) 16 *New Zealand Economic Papers* 41, 42.

¹³⁷ Martin et al, above n 135. See also Margaret Lamb, 'Interdisciplinary Taxation Research — An Introduction' in Margaret Lamb, Andrew Lymer, Judith Freedman, and Simon James (eds) *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press, 2005).

¹³⁸ Murphy and Nagel, above n 2.

comparisons could provide further evidence as to the role of ideas in tax policy, as well as of the flow of these ideas.

This article is also limited to a review of the views of one philosopher. A discussion of differing views would enhance understanding of the development of tax policy. Furthermore, this article describes, but does not critique, Hayek's philosophy; for example, his apparent assumption that evolution precludes human intervention is questionable; why should humans not intervene to improve matters? Moreover, since Hayek does not discount all government intervention, why should the line be drawn where he placed it?

A review of additional sources, especially government policy papers in relation, for example, to accelerated depreciation and investment allowances (if these are available), as well as the public reaction to these measures (eg in the newspapers), would also provide a fuller understanding of the role of taxation in the past and in society.