General or discrete? Hayek and the politics of New Zealand’s tax depreciation

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ABSTRACT

Since 1894, New Zealand income tax legislation has allowed taxpayers a deduction for the depreciation of assets used in the production of their assessable income. Tax depreciation reflected accounting practice, and the general depreciation rules applied indiscriminately to all eligible taxpayers.

Following the Second World War, the Government enacted discretionary policies, such as initial depreciation and investment allowances, to induce investment and to promote the economic development of particular industries or regions. Such policies reflected a trust in government policy to achieve a society’s (economic) goals. Since 1984, however, the focus of New Zealand’s economic policy has shifted to efficiency, with a returned reliance on the market, rather than the government, to promote economic development and growth. This was reflected in taxation policy, with a removal of tax expenditures, including discretionary depreciation policies, in favour of a broad-base, low-rate tax system.

This article addresses the development of tax depreciation policy in New Zealand in the light of the writings of Friedrich Hayek. During the war, Hayek (2007) had warned against the dangers of economic planning, and he subsequently contrasted two views of liberty: one aimed at specific outcomes resulting from specific government interventions, the other based on end-independent rules common to all (1982, 2006). While his views were largely ignored until the 1980s, both pre-war and more recent policy is more consistent with the latter rather than the former view.

This article highlights the (often unstated) philosophical disagreements on taxation policy and policy change. It also contributes to the gap in the literature on tax depreciation and suggests opportunities for future international comparisons. Like taxation in general, and in keeping with the Conference theme, changes in the practice of tax depreciation demonstrate the political nature of tax.
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INTRODUCTION

*The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else.*

Joseph Schumpeter (cited in Martin et al., 2009, p. 1)

Prior to World War Two, tax depreciation was governed by a general rule which applied to all. Following the War, the general rule was supplemented with specific provisions designed to achieve particular outcomes and which had limited, rather than general, application. This was consistent with the more general shift from a *laissez faire* to a planning approach to economic policy. Since the 1980s, however, there has been a shift back to the market rather than central planning as the basis for economic policy, and changes to depreciation policy in recent years have mirrored this change.

The adoption of planning is often associated with the British economist John Maynard Keynes. However, this interventionist approach to economic policy was not without its critics, of whom perhaps the best known was Friedrich Hayek. In 1944 Hayek published *The Road to Serfdom* in which he warned of the dangers that planning posed to liberty. Hayek subsequently expanded on this theme in *The Constitution of Liberty* (2006a) and *Law Legislation and Liberty* (1982), in which he contrasted a liberty sought in spontaneity and the absence of coercion, and one sought in government; one based on empiricism and trial and error, the other based on rationalism and prescribed pattern; one based on price-sIGNALS provided by the market, the other on signals provided by government planning (Hayek, 2006a, p. 51).

Depreciation policy provides a case study of the use of taxation policy to achieve government policy goals. Moreover, the shift from a general, common law-based approach to depreciation policy to one based on specific commands indicates a shift in the role of government from providing equal opportunities for all, to one of “picking winners”, if necessary by means of discriminatory legislation to achieve specific ends. Hayek argued that this shift endangered liberty, and was prone to fail. This article discusses the development of taxation depreciation in New Zealand in the light of Hayek’s philosophy.

The article proceeds as follows. The next section outlines the background to and approach of this article. The following section explores Hayek’s views as he presented them in his main works. New Zealand tax depreciation history is then discussed through the lens of Hayek’s thought, before the article summarises and concludes.

This article makes several contributions to our understanding of taxation. It utilises an under-researched context, namely taxation depreciation, to extend our understanding of taxation policy more generally. Hayek’s views provide a lens through which to assess this policy, and highlight the (often unstated) philosophical assumptions and beliefs that underpin (taxation) policy. Taxation is inherently political, and politics is (implicitly or tacitly) informed by philosophy. Moreover, by considering a range of sources, this research enhances our understanding of the world in which we live, and of the role of tax in forming that world.
BACKGROUND AND APPROACH

Until the mid-Twentieth Century, New Zealand’s central government played a limited role in economic affairs, providing the night-watchman functions of internal and external security, as well as developing the country’s infrastructure.¹ The events of the 1930s and 1940s provided motivation for significantly increased government intervention in the market and a preference for economic planning.² Contrary to the received economic wisdom, the mass unemployment of the 1930s suggested that an economy either would not reach a stage of equilibrium at full employment over time, or that the human cost of letting the markets find their own equilibrium was unacceptable, and so the government should intervene (Wapshott, 2011, p. 31). The subsequent war years required mass mobilisation of manpower and resources for the war effort, and the success of this effort provided justification to continue the wartime command economy into peacetime (Hawke, 1985).

After the war, maintenance of full employment became a key goal of government economic policy in New Zealand. The 1960 Industrial Development Conference reflected this post-War economic priority and “endorsed the policy of full employment which is included in the full use of all resources (Industrial Development Conference, 1960, p. 79).” The Conference noted that “the aim of monetary and fiscal policy should be to maintain full employment, high production and rising standards of living, and the economic development of all resources, with sufficient restraints to ensure stability in costs and prices (p. 143).” To achieve this, the Conference endorsed incentives to industry (p. 89), including the accelerated write off of capital costs (p. 147) and regional incentives (p. 121).

Full employment was also the goal overseas (Booth, 1983; Tomlinson, 1996; Dalton, 1954),³ and frequent adjustments to taxation rules provided a means to this end. These adjustments were based on “short-term political expediency rather than consistency (Daunton, 2002, p. 256).” Planning was justified by its promises – irrespective of whether the promises were fulfilled.

The shift from market to planning was championed by John Maynard Keynes. In A General Theory of Employment, Interest and Money, published in 1936, Keynes (2008) commented that “the central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government (p. 237).” To ensure full employment, government should intervene in the market to encourage investment which would promote production and employment. This would involve centralised action to overcome the vagaries of the market, and the state’s actively inducing, rather than merely maintaining, the conditions for individuals to realise their economic goals. Keynes (2008) concluded, “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 (p. 235).”

¹ For example, during the 1870s, Premier Julius Vogel borrowed significant sums from overseas to enhance New Zealand’s infrastructure (Dalziel, 2007).
² Tomlinson (2005) notes the role of the British state’s fighting of a “total war” during the First World War as presaging the shift to a managed economy. This shift was confirmed by the needs of the Great Depression and World War Two.
³ “Economic policy was presented as a clash between an entrenched orthodoxy and an intellectually and morally superior force, Keynesianism, which eventually triumphed with the commitment to maintain high, stable levels of employment in the 1944 White Paper (Booth, 1983, p. 104).”
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Keynes has been characterised as “pragmatic” (Caldwell, 1998, p. 560). His approach to economic policy was utilitarian, concerned with short to medium term outcomes, since (as he once famously declared), “in the long run we are all dead (Keynes, 1923, p. 80).” If the means were available for a society to improve its lot, they should be applied.

Hayek did not publish a review of Keynes’s General Theory (Caldwell, 1998), but criticism of its prescriptions is found throughout his work (Sanz Bas, 2011). Hayek repudiated reliance on the macro-economic planning promoted by Keynes. Wapshott (2011) portrays the ensuing debate between Hayek and Keynes and their followers as “The clash that defined modern economics.” The basic point of contention was the “competing claims to virtue of the free market and government intervention (p. xiv).”

The contrasting policies are evident in New Zealand history. Post-War New Zealand prior to the economic reforms of the 1980s has been described as “a country reformed by Keynesians, run by pragmatists, and populated by socialists (Brash, 1996).” Although the subsequent reforms could be labelled Hayekian, his name was rarely invoked and the extent of any 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 (Brash, 1996). Similarly, Roger Kerr, Executive Director of the New Zealand Business Round Table, an organisation said to be strongly influenced by Hayek (Harris and Twiname, 1998), had never read Hayek (Perigo, 1996). 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. McAloon (2013) summarises that while Keynesian approaches dominated policy in democratic states after 1945, Hayekian ideas were evident in New Zealand in the 1940s and again appeared after 1984.

Irrespective of whether their works had been read by policymakers, the contrasting views of Keynes and Hayek are reflected in New Zealand’s economic history. Rankin (1998) comments that since 1984, the New Zealand economy took a “diametrically opposite direction from the 1938 to 1975 strategies (p. 211).” These policies were similar to those pursued prior to World War Two. Keynes and Hayek could provide shorthand labels to describe New Zealand economic policy: pre-World War Two – Hayekian; World War Two to 1984 – Keynesian; post-1984 – Hayekian.

Yet despite their convenience, such labels easily become mere jargon – useful for polemical purposes, but hardly informative, particularly when applied to something as large and amorphous as a national economy. Rather than attempt to describe a whole economy, careful attention to a smaller domain may provide useful insights into the development of that economy.

Evans et al., (1996) suggest that “the key theme of the macroeconomic approach of both the monetary and fiscal authorities through the reform period [post-1984] has been to provide stable policies rather than stabilisation policies (p. 1863).” Tax depreciation policy provides

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4 Douglas makes no mention of Hayek in his writings. His successor, the National Party Minister of Finance Ruth Richardson and equally an economic reformer of a neo-liberal stripe, also does not mention Hayek in her political biography, although she does mention speaking at a Mont Pelerin Society meeting (Richardson, 1995, p. 5).
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an illustration of the shift from a stable policy (pre-1945), to stabilisation policy (1945-1984), and then back to a more stable policy (post-1984) in New Zealand. Changes in tax depreciation policy illustrate that changes in economic and social policy are reflected in a society’s taxation (Martin et al., 2009).

This article considers Hayek’s views on economic planning and illustrates this in the context of the development of tax depreciation policy in New Zealand.

Approach

The practice of taxation reflects philosophical and ethical views. Murphy and Nagel (2002) comment concerning discussions of political legitimacy that:

A fundamental division runs through these debates, between two types of normative theory – those that focus on outcomes, conventionally called “consequentialist,” and those that focus on actions, conventionally called “deontological” (from the Greek word meaning “ought”). (p. 42)

The first approach focuses on the aims or results of the policy. This consequentialist approach would evaluate a policy in terms of its consequences, and the policy would be end-dependent. Ultimately its effectiveness can only be evaluated ex post. In contrast, a deontological approach evaluates an action on the basis of a pre-specified standard or conditions. A policy may be evaluated ex ante against this standard, and may be considered “good” irrespective of its effects.

Martin et al., (2009) note that taxation is a major partisan battleground, and suggest that “the rise of neoliberal ideology has propelled taxation onto the international policy agenda (p. 1).” Since Hayek is considered a doyen of neoliberalism (Steger and Roy, 2010; Chabrak, 2012), his views would seem relevant to the discussions of tax policy development. However, Murphy and Nagel (2002) lament that, “Whatever the reason, there seems to us to be a gap or at least an under-populated area in philosophical discussion of the ethical dimensions of public policy (p. 4).” “Hayek”, like “Keynes” easily devolves into a mere label or stigma, rather than a set of ideas to be pondered, examined, and critiqued as we endeavour to make sense of the world and improve society.

This article adopts an inductive, historical comparative approach which involves the application of a theory to a specific case to illustrate the usefulness of the theory (McKerchar, 2009, p. 117), but also to strengthen conceptualisation and to elucidate the past. In particular, Hayek’s philosophy is discussed, and then provides a model against which to discuss the development of tax depreciation in New Zealand. This approach is consistent with that of the New Fiscal Sociology in recognising that taxation “has a theoretical or causal – and not just a symptomatic or methodological – importance (Martin, 2009, p. 3).”

Periodisation helps to structure the past by breaking continuous time into periods for analysis (Jordanova, 2000; Neuman, 2006). This article discusses the development of tax depreciation in New Zealand in three periods as previously noted: pre-World War Two; from World War Two to 1984; and after 1984.

The next section outlines key aspects of Hayek’s philosophy, and considers how these relate to the practice of tax depreciation.
HAYEK AND PLANNING

The publication of The Road to Serfdom in 1944 (Hayek, 2007) brought Hayek to public attention, especially after it was condensed and distributed by Reader’s Digest (Hayek, 1945). In this work Hayek expressed alarm that, “There exists now [in Britain] 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 (2007, p. 58).” As he saw it, the very enemy that Britain had recently fought was now being embraced by its economic policy. Economic planning was a move towards socialism, which, though it might seem benign, would inevitably lead to slavery; “We have progressively abandoned that freedom in economic affairs without which personal and political freedom has never existed in the past (ibid., p. 67).” Hayek developed his views in his two magna opera, The Constitution of Liberty (2006a), and Law, Legislation and Liberty (1982), (Ebenstein, 2001, p. 217). While Keynes promoted macro-economic planning, Hayek argued that such planning was ultimately futile and indeed harmful.

Rules and the Rule of Law

The distinction between arbitrary rules and the Rule of Law was basic to Hayek’s argument: “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 (2007, p. 112, cf. Jones, 1958).” Under the Rule of Law, governments are confined to fixing general and formal rules – “rules of just conduct (Hayek, 1967, p. 162)” – intended to be merely instrumental in the pursuit of people’s various individual ends, and enabling people to predict the behaviour of those with whom they must collaborate. Because such rules are end-independent, they are of universal significance and can be applied to new cases (1982, p. 62). Hayek approvingly cited Lord Mansfield’s dictum that the common law “does not consist of particular cases, but of general principles, which are illustrated and explained by these cases (1982, p. 82). In contrast, economic planning “must provide for the actual needs of people as they arise and then choose deliberately between them (2007, p. 113).” For Hayek, a liberal society is a society under law, not regulation.

Hayek summarised his “liberal” vision of society as follows:

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5 In a 1933 memorandum entitled Nazi-Socialism, Hayek had 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 Bismarkean era” (Hayek, 2007, p. 245).

6 Keynes wrote to Hayek concerning The Road to Serfdom that: 
In my opinion it is a grand book ... morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement, but in a deeply moved agreement. (Wapshott, 2011, p. 198).

Keynes continued, however, “I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more.” This contradicted the very point that Hayek was trying to make.

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 (1967, p. 162).

Universal rules promote human flourishing.

Evolution and human ignorance

Underlying Hayek’s thesis is evolution, which he applied to social order (Ebenstein, 2001, p. 151). For Hayek the basic philosophical difference in social ethics is that between an evolutionary, as opposed to a constructivist, rationalism (1982, p.5), which he also referred to as an Anglican versus a Gallican view of liberty (2006, p. 49f). He rejected the latter, arguing that the view that social institutions had been deliberately designed to serve human purposes was “rooted originally in the deeply ingrained propensity of primitive thought to interpret all regularity in phenomena anthropomorphically (1982, p. 10).” 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 accidentally, were preserved because they enabled the group in which they had arisen to prevail over others (p. 10).” Social evolution, rather than a higher supernatural intelligence or a designing human intelligence, accounted for the order evident in the world (2006a, p. 53). Anticipating the 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 that of individuals (1982, p. 23).”

Consistently with his evolutionary assumption, Hayek emphasised the significance of human ignorance. Whereas complete rationality of action demands complete knowledge of all the relevant facts, 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 society (1982, p. 13)”, something our ancestors (i.e. the nineteenth century Liberals) well recognised (1982, p. 21). Evolution proceeds in a context of ignorance.

Evolution and progress

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:

Advance is achieved by our moving within an existing system of thought and endeavouring by a process of piecemeal tinkering, or ‘immanent criticism’ to make

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8 Hayek includes religious belief as one such anthropomorphical attitude. It is therefore rather surprising that the religious right is 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 (p. 249).”
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the whole more consistent both internally as well as with the facts to which the rules are applied (1982, p. 113).

The fact of human ignorance means that it is not possible to short-circuit this process of trial and error. For planning to be successful, the planner must either know everything (which is impossible), or must operate based on limited, fallible information and therefore make mistakes. Conversely, where end-independent rules – “abstract rules independent of any particular result aimed at (1982, p. 93)” – rather than ends are specified, expectations are not thwarted and progress may occur. Since knowledge is not concentrated in any one mind (1982, p. 40), individuals should be permitted the maximum freedom to undertake their plans, and be provided the maximum of certainty as to the social structure in which they will be operating.

In the absence of central direction, how do individuals know how to act, and how is welfare maximised? Hayek argues that prices play a key role in signalling to market participants the need to change or to maintain the direction of their efforts (1982, p. 235). Where governments intervene in the market, price signals may be distorted by altering the relative costs of competing opportunities. By reducing the cost of a possible investment, (for example, by accelerating or increasing the permitted tax depreciation deduction), resources may flow into an area that would otherwise be uneconomic or sustainable. 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.

Where it is not impeded by ends-directed government action, Hayek argued that the order of the market best serves human flourishing by increasing everyone's prospects of gaining a greater command over various goods than they might secure in any other way (1982, p. 267). In a market order, outcomes are unknown. What may be known are the ground rules which create a level playing field for all participants. Where these are pre-specified and only change incrementally, participants can make plans for the future. In contrast to planning, Hayek argued that the task of rules of just conduct is to tell people what expectations they can count on and which not, rather than to guarantee or even promote specific outcomes (ibid., p. 97).

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 all (1982, p. 288). Indeed, it is desirable that participants be permitted to fail if progress is to be made. While market participants run the risk of loss, only as success and failure occur can there be progress (ibid., ch. 10). 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:

In 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 (1982, p. 178).
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The role of government

Despite this, Hayek was not opposed to government per se. While governments are ineffective in, if not detrimental to, achieving specific ends (since outcomes cannot be known in advance), 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 (1982, p. 178).

Hayek argued that “we find it 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 (1982, p. 382).” This would include providing a range of services “to preserve peace and to keep out external enemies (1982, p. 119)”, as well as those services where the market is not the most effective method of provision (1982, p. 383). Governments should also provide “some security against severe deprivation (1982, p. 294)” 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 (1982, p. 395).” Coleman (2013) aptly summarises Hayek’s view of government: “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’ (p. 89, emphasis in original).”

While governments must use coercive powers to raise finance (i.e. taxation), this does not necessarily imply that the government should use coercion to plan society, since provision by the government was “an inferior method of providing those services (1982, p. 387)” compared to the “more efficient method of the market (ibid.).” Consistent with his evolutionary thesis:

- every step made in this direction [of increasing government provision of resources] means a transformation of more and more of the spontaneous order to society that serves the various needs of the individuals, into an organisation which can serve only a particular set of ends determined by the majority – or increasingly, since this organisation is becoming far too complex to be understood by the voters, by the bureaucracy in whose hands the administration of these means is placed (1982, p. 393).

Hayek and depreciation

Form the above it is clear that Hayek eschewed tax expenditures, “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 (Surrey, 1985).” Although Hayek does not directly address

9 Hayek proposed a new constitution where there was a “real separation of powers between two distinct representative bodies whereby law-making in the narrow sense [i.e. relating to general rules of just conduct] as well as government proper [i.e. administrative law] would be conducted democratically, but by different and mutually independent agencies (1982, p. 443).”
the question of tax depreciation, it is clear that he would favour general (e.g. Common Law) rather than specific, discriminatory statutory provisions. Since general depreciation rules are “end-independent, and refer only to facts which those who are to obey them can know or readily ascertain (Hayek, 1982, p. 205),” they provide 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 between industries or locations provide little certainty, as they could change at any time, and are subject to administrative discretion. Moreover, such rules may serve to protect particular interests and privilege (ibid., pp. 184, 372), foster corruption (ibid., p. 354), and enhance the power of pressure groups (ibid., pp. 420, 472).

Hayek suggests that discriminatory (tax) policies are both inefficient and inequitable. Such rules are *inefficient*, since it is not possible to preserve a market order while imposing on it some pattern of remuneration (p. 232). Since both individuals and governments operate under a veil of ignorance,\(^{10}\) 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 medium to long terms. According to Hayek, “governments notoriously fail, for reasons inherent in non-competitive bureaucratic organizations (1982, p. 260)” to direct investment in the most effective ways.

Moreover, such rules are *inequitable*, since a government disturbs previous expectations when it enacts laws that favour one group over another. Social change and technical obsolescence will result in failure, but such failure provides signals available to all whereby they may adapt their behaviour. Failure due to 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 (1982, p. 300). Discrete policy which interferes with the market is thus unfair.

**Summary**

The foregoing discussion suggests several questions concerning tax depreciation.

- Does the policy provide general rules that apply to all or does it discriminate between persons (non-discrimination criterion)?
- Does the policy reflect evolving social practice or is it imposed by the government (spontaneity criterion)?
- Does the policy permit taxpayers to plan for the future or is it subject to regular and unpredictable change (certainty criterion)?
- Is the policy end-independent or is it motivated by an attempt to achieve particular ends (end-independence criterion)?

These questions will be addressed in the summary of each of the three periods addressed in the following section.

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\(^{10}\) Hayek (1982) expresses appreciation for the work of John Rawls at e.g. p. 261.
HAYEK AND THE DEVELOPMENT OF TAX DEPRECIATION IN NEW ZEALAND

Three distinct phases may be discerned in the development of tax depreciation in the New Zealand income tax. These are discussed sequentially.

From 1894 to the end of World War Two

The capital/revenue distinction inherited from Britain is basic to the New Zealand income tax. While the origin of this distinction is debated (Prebble, 2002, p. 302; Holmes, 2001, pp. 232ff; Elliffe, 2010, p. 181; Harris, 2006, pp. 131ff), it became particularly relevant for accounting purposes during the Industrial Revolution, since an over-valuation of assets due to inadequate depreciation could result in shareholders receiving returns from capital rather than revenue sources, thereby depleting an entity’s capital. The distinction also was and remains relevant for income taxation purposes since the valuation of assets affects the amount of income tax payable.

England introduced a modern income tax in 1842.11 As long as the tax was not intended to be permanent, depreciation was not a major concern, and the legislation made no provision for depreciation. As the tax became a permanent feature of the fiscal landscape, an inability to claim depreciation resulted in the under-assessment, and hence under-taxation, of income. However, despite the legislative silence, tax inspectors apparently did allow depreciation to be claimed based on industry practice,12 which itself evolved over time. After a Court of Appeal judgment rejected a claim for depreciation,13 the British legislature amended the Income Tax Act in 1878 to allow “such deduction as [the Commissioners of Taxation] may think just and reasonable as representing the diminished value by reason of wear and tear during the year of any machinery or plant used for the purposes of the concern.”14

New Zealand’s income tax reflected aspects of its British heritage. While its legislation differed from the British 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 legislation15 was rather short and provided little detail. In particular, the original Act made no mention of depreciation. A strict view 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 (Cunningham, 1933, para. 397).” More likely, there was no need to legislate for depreciation since it was common commercial practice to

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11 Income Tax Act 1842 (UK) 5 & 6 Vict c 32
12 “Report from the Select Committee on income and property tax with the proceedings of the committee, ordered, by the House of Commons, to be printed 21 July 1851 (Cmd 563)”, in Irish University Press Series of British Parliamentary Papers (Shannon, Ireland, Irish University Press, 1968-69) at 154, 298ff., 386ff.
13 Forder v. Andrew Handside and Company (Limited) 45 LJR 809.
14 Customs and Inland Revenue Act 1878 (UK) 41 Vict c 15, s. 12.
15 Land and Income Assessment Act 1891.
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 (Valabh, 1991, p. 109).” Unlike statute, the Common Law allows for discretion and adaptation to emerging situations.

In 1894 Parliament amended the 1891 Act to make express provision for depreciation by adding a proviso to Schedule F:

Provided that the Commissioner may allow such deduction for depreciation of 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, not being of a kind that could be made good by repairs, or by the implements, utensils, or machinery being rendered obsolete or useless.16

This provision was subsequently amended to permit a deduction for an asset that had become obsolete or useless.17 A deduction for the depreciation of buildings was finally permitted in 1917.18 Pervious failure to allow this 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 1920.19 Even after these amendments, there just a single section in the Income Tax Act pertaining to depreciation until 1945.

The depreciation regime operated at the Commissioner’s discretion. However, while the Commissioner published allowable rates of depreciation, rates were published in broad bands which applied to all taxpayers. Any distinction in rates related to 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 (i.e. economic) depreciation of the asset. Moreover, the rates changed infrequently.

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

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 (p. 5).

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

16 Land and Income Assessment Acts Amendment Act 1894, s. 18.
17 Land and Income Assessment Act 1900, s. 66(1).
18 Finance Act 1917, s 30.
19 Land and Income Tax Amendment Act 1920, s. 17.
Prior to World War Two, then, New Zealand’s depreciation policy largely conformed to Hayek’s prescriptions. Rather than being imposed, it reflected and was informed by evolving commercial practice, reflecting the spontaneity criterion. The provision in the Act was short and general, and was intended to apply indiscriminately to all eligible taxpayers. Since the 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 pricing signals provided by tax depreciation was not likely to change in the foreseeable future; that is, the government would not capriciously alter long-standing policy 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.

From World War Two to 1984

Economic policy responded to crisis. To avoid 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 World War Two provided a pattern that was followed into peacetime (Hawke, 1985). 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 Gibbs Taxation Commission which included as purposes of taxation, “the protection of industries or control of spending”, and “the promotion of employment (para. 60).”

Throughout this period, the basic depreciation provision in the Income Tax Act remained largely unchanged.20 However, from 1945 a number of additional sections supplemented this provision. Effectively New Zealand had a “dual system” of depreciation (Gibbs, 1951, para. 284); 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.

Accelerated depreciation

The Labour Government’s 1945 Budget was delivered following Victory in Europe, and with Victory over Japan anticipated. In his budget, the Minister of Finance noted that “the Government’s policy is one of full employment.”21 This 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 (ibid.).” Hence the “predominant objective in our post-war activities (ibid.)” 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:

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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.\textsuperscript{22}

This measure would 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 only to certain assets. Moreover, as with depreciation more generally, accelerated depreciation was at the discretion of the Commissioner. Not only did this create a lot of paperwork, it reduced certainty, which is a hallmark of not only a good tax system, but of the Rule of Law itself.

Accelerated depreciation was extended to a larger range of assets and businesses before its abolition in the 1990s.\textsuperscript{23} This included plant, machinery, or equipment or employee accommodation provided for the purpose of any farming or agricultural business in New Zealand”,\textsuperscript{24} and worker’s accommodation other than for farming or agricultural employees.\textsuperscript{25} Moreover, both the rates and the extent of accelerated depreciation were subject to frequent adjustment.

\textit{Investment allowances}

Like his Labour counterpart, National’s Minister of Finance accepted the government’s role of steering the economy. The objective of his 1963 budget was “to provide added incentives which will help to accelerate New Zealand’ progress – incentives for development, for production, for exporting.”\textsuperscript{26} In the Minister’s view, “investment in both industrial and agricultural plant is not large enough”,\textsuperscript{27} which 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.\textsuperscript{28}

\textsuperscript{22} NZPD, Vol. 272, (3 December 1945), pp. 289f.
\textsuperscript{23} Income Tax Act 1994, s. YB 3(1).
\textsuperscript{24} Land and Income Tax Amendment Act (No. 2) 1950, s. 8.
\textsuperscript{25} Land and Income Tax Amendment Act 1953, s. 12.
\textsuperscript{27} Ibid., p. 505.
\textsuperscript{28} Although Simcock (1963) 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 (p. 66)”, 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.
Investment allowances initially applied to new manufacturing and agricultural plant and machinery, and to investments in redevelopment projects on the economically depressed West Coast of the South Island. 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 (cited in Staples, 1976, para. 693).

Accelerated depreciation and investment allowances supplemented ordinary depreciation with measures that were intended to alter taxpayer behaviour. Rather than leaving the market, via the price system, to inform decision-making, these measures were aimed at achieving or promoting particular outcomes by altering the incentives (i.e. the pricing information) available to taxpayers. Moreover, unlike general depreciation, these measures were subject to change, and in contrast to the general depreciation the legislation was, to put it mildly, “rather long and somewhat complicated.”

While special depreciation and investment allowances remained in place 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 (Ross, 1967, para 631).” 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 (ibid., para. 634).”

Summary
Like other selective depreciation measures, accelerated depreciation and investment allowances were inconsistent with Hayek’s views. These measures are discriminatory, favouring particular taxpayers over others, and potentially leading 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 (e.g. criteria, rates) would lead to short-term rather than long term planning, and hinder innovation. Overall, such policies were end-focused, and thus likely to fail, 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, according to Hayek, indicated a march toward serfdom as planning supplanted the Rule of Law.

Moreover, as measures of end-focused law-making, these measures contrasted with the general depreciation provision which, like the Common Law (which Hayek favoured over positive law (2006, pp. 49ff.; 1982, p. 80f.), was end-independent. This reflected a shift in the principles of tax law policy from general principles accepted by all, to discretionary law in

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which “the accent is heavily on incentives”, 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,” their Finance Spokesman, Mr Connelly, expressed concern that these measures:

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.

Like Keynes, the New Zealand Parliament was prepared to supplement, if not supplant, 200 years of accepted principle to achieve pragmatic goals.

After 1984

Before the 1984 General Election, Robert Muldoon had been both the Prime Minister and 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 (1984-1990):

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 (Muldoon, 2005, p. 119).

Muldoon’s view contrasted starkly with the policies adopted by his successor.

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 (Gustafson, 2000, pp. 277-89).

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 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 (McCaw, 1982, para. 4.18).” This continued a theme already noted by the 1967 Ross Committee.

30 Ibid., p. 2603.
31 Ibid., p. 2607
32 Ibid.
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 (Treasury, 1984, p. 210). In particular, “many of its features are contrary to any reasonable efficiency and equity criteria. Rectification of these defects will require significant structural changes (ibid.).” As regards taxation incentives, Treasury sounded a Hayekian note:

Expenditure – and 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 choices … (1984, p. 220).

Treasury identified accelerated depreciation measures and investment allowances as tax expenditures, noting that “Frequently the tax system is a very poor method of targeting assistance, assuming that assistance is justified in the first place (1984, p. 227).”

The Labour Government undertook substantial tax reforms in the 1980s to broaden the tax base and lower tax rates. Depreciation was not exempt from these reforms. In particular, both accelerated depreciation and investment allowances were phased out by 1993.

The government also significantly reformed the depreciation provisions in the Income Tax Act in 1993. While these reforms were largely administrative, they did introduce the concept of “economic rates of depreciation”, 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 (para. 8.6.3). Ex ante and non-discriminatory rules replaced arbitrate and discriminatory policy.

The depreciation rules were further reformed following the release of the report of the Tax Working Group (TWG) 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 (p. 54).” 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 (ibid.).” The government removed the loading.

The TWG report does not specifically mention Hayek; however, its focus on efficiency and the need for clear market signals is consistent with his views. According to the TWG, “A good tax system should minimise the harm it does to growth … minimise distortions to investment allocation decisions (p. 59)”, which it does best by allowing the market to provide signals to investors.

The current broad-base, low-rate focus of New Zealand tax policy (Tax Working Group, p. 14) contrasts with the planning approach evident in depreciation policy in the decades.

33 Maples, (2013), para. 2.2.8, provides a list of the tax reforms undertaken since 1984.
34 Income Tax Amendment Act 1993, s. 27(b).
35 Income Tax Amendment Act (No 2) 1990, s. 63.
General or discrete? Hayek and the politics of New Zealand’s tax depreciation following World War Two. New Zealand returned to a single system of tax depreciation, intended to reflect the economic loss in the value of an asset. In contrast to overseas jurisdictions, few incentives remain. The 2001 Tax Review indicated the extent of change in tax philosophy in New Zealand:

The current system developed over the years since McCaw 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.” (McLeod et al., 2001, para. 1.44f.)

In summary, since 1984 New Zealand tax depreciation policy increasingly reflected the deontological basis evident before World War Two. The current Income Tax Act reflects a general rule which applies to all, rather than discrete policies that discriminate between taxpayers. Changes to allowable rates must be justified on economic rather than policy grounds, reflecting economic and social realities, rather than the preferred outcomes of the government. Rather than game-play, or suffer frustration of their expectations, consistent depreciation policy assists 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 ITA, depreciation may be claimed irrespective of the industry type of activity in which the asset is used.

CONCLUSION

Social scientists and historians have paid little attention to taxation; yet taxation provides the largest and most pervasive intervention of government in the lives of most people and directly affects their business activities. While this may be obvious in relation to the actual payment of tax, the rules upon which assessment is based also have social causes and social effects. Tilly aptly summarises: “the circulation of resources from subjects to government-initiated activities provides a sort of CT scan for a regime’s entire operation (Tilly, 2009, p. xiii).”

Tax depreciation policy illustrates, at a micro level, philosophical changes in a nation’s economy, but also in society more generally. The shift from a single system of depreciation that reflected extant commercial practice prior to World War Two, 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 (Martin et al., 2009, p. 1).

Moreover, tax depreciation provides a very practical illustration of the effects of two contrasting policy perspectives: the principles-based, deontological theory of Hayek, and the pragmatic, consequentialist approach advocated by Keynes. In general terms, tax depreciation

\[36\] 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.
policy in New Zealand reflected the former until 1945, the latter until 1984, and since then has again increasingly conformed to the former.

Several implications may be drawn. First, ideas matter. Both the shift to planning and incentives following World War Two, and the shift back to the market after 1984, had an ideological basis. Even if Keynes and Hayek are not mentioned by name and their works are not read by politicians and officials, they can and do affect policy. The thought of (tax) philosophers may affect tax policy. The broad-base, low-rate approach to tax policy has theoretical underpinnings which could provide a more explicit “conceptual framework (Lewis, 1982, p. 42).” for taxation policy development. An appreciation of contrasting philosophical approaches leading to an understanding of tax history should enhance criticism and improvement of tax policy, not to mention tax teaching.

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 perceived ability of an economy to adopt the planned economy of wartime for peaceful ends. Likewise, the shift away from planning was in part a reaction against the failings of the previous 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 (Martin et al., 2009) 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 tax policy. While contested, taxation is largely taken for granted. Murphy and Nagel (2002) lamented the gap, or at least under-populated area in philosophical discussion of the ethical dimensions of public policy. This is also true of tax policy. While explicit statements of tax philosophy might be castigated as “ideological”, any policy will reflect 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 improve our understanding of taxation policy. It may also improve the politics of tax.

Further study

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 Keynesian path after World War Two and neo-orthodox path after 1980, international comparisons would provide further evidence as to the role of ideas in tax policy, as well as of the flow of these ideas.

While Hayek provides detailed discussions of his ideas, Keynes’s ideas have been described as pragmatic, and Keynes himself as being quite willing to change his mind. A discussion of Keynes’s views as they related to tax policy would provide a contrast to Hayek, and could enhance understanding of post-War policy. Moreover, this article describes, but does not critique Hayek’s philosophy. In particular, his apparent assumption that evolution precludes human intervention is questionable; why should humans not interfere 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 (for example, in the newspapers) would also provide a fuller understanding of the role of taxation in the past and in society.

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