Is it Just Tax?
The shaping of our society
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Is it Just Tax?
The shaping of our society

by Alex Penk
TABLE OF CONTENTS

EXECUTIVE SUMMARY v

SECTION 1 - Introduction to Tax, Justice and Freedom 1

SECTION 2 - Theories of Fairness and Justice 13

SECTION 3 - Decision Time: How to assess justice in taxation 29

SECTION 4 - Concepts of Freedom 35

SECTION 5 - Assessing Freedom 41

SECTION 6 - Policy Implications 49

SECTION 7 - Summary and Conclusion 69

ABOUT THE AUTHOR/ACKNOWLEDGEMENTS 71
Deciding how to tax, what to tax and how to spend the money are issues all democratic governments have to grapple with. These are not easy decisions, and they bring up difficult questions about the appropriate level of taxation, how much of their own money people should keep, and the things that the government should do on behalf of its citizens. The answers to these questions will depend on how we view the government’s role, and what we think about the way society should look, the way people should be treated and the amount of responsibility they should have.

The first discussion paper in this series considered how the role of government could be understood, and the implications for taxation. It proposed that the government’s role is to protect the common good from threats of harm where to do so is consistent with proper custom and tradition and respects the principle of subsidiarity. It concluded that this provides the yardstick for government action and therefore for taxation to fund those activities. This discussion paper continues the series by taking up the questions about the way society looks and the way people are treated and act. These questions are usually answered by theories of justice and compassion, freedom and responsibility. These issues are part of a bigger question about what we want our country to look like, so they have implications for many areas, including taxation, which is the specific focus of this paper.

Is it fair and just that New Zealand should spend $2.7 billion on Working for Families tax credits that will be received by “around three quarters of … families with children”? Should those without children be required to supplement the incomes of those that do have them? Do the credits represent a compassionate measure, even though “Working for Families is not primarily an anti-poverty package”? Is it appropriate to use tax credits to try to influence some people to work? Does it matter that they create “poverty traps” for others by discouraging them from higher-paying roles? To take another example, if “the rich” should pay more in taxes than “the poor,” how much more should they pay, and how should this be determined? Is it just that the top 5 percent of taxpayers pay 29 percent of the personal income tax while the bottom 78 percent pay 34 percent?

Questions such as these can only be answered by reference to a bigger picture. The first paper in this discussion series proposed that this bigger picture is provided by the concept of the common good, “the irreducible goods which are good for every person everywhere.” This concept helps us to understand the ideals of justice, freedom and compassion, and to reconcile them when they conflict.

Despite the importance of the issues, they are not well understood. Although “fairness” dominates the current debate about taxation, there is little in-depth discussion about what fairness or justice actually is, and why it is what it is. The debate often seems to merge issues of justice with those of compassion, and even less attention is paid to the relationship between tax and freedom. All of these issues are critically important and worthy of closer examination.

JUSTICE

Our view of justice underpins our entire system of government. Although the requirement to act justly is not limited to government, the demands of justice typically create legal entitlements and expectations enforceable by the state. In concrete terms, this affects when, where and how government can
intervene and take responsibility in our lives, sometimes directing or even forcing us down paths we would not otherwise choose. This in turn affects the size of government and the level of funding it requires, funding that we provide through taxation.

“Fairness” or justice—terms which are used interchangeably in the current tax debate—is currently a key concern for tax policy. However, these terms are given several meanings, some of which are contradictory. Often they are thought to mean “reducing inequalities,” whether of income, wealth, or something else, and this version of justice regards redistribution as a legitimate way to achieve greater equality. The progressive personal income tax reflects this view, taking a greater percentage of income from “the rich” than it does from “the poor,” and policies like Working for Families redistribute that income to selected recipients.

Whether this is truly just depends on what justice is. Theories of justice can be divided into two general camps: those that measure justice by whether particular outcomes are achieved, and those that measure justice by whether particular processes are followed.

Concerns about equality of incomes or wealth, redistribution and distributive justice are concerns about justice in outcomes. So too are many of the so-called “traditional criteria of tax justice,” like the idea that the tax burden should be allocated in accordance with taxpayers’ ability to pay so that they make equal sacrifices when they pay their tax, or that the benefits that taxpayers receive from tax-funded services provide a basis for sharing out the tax burden. By contrast, justice in process does not ask about the distribution of the tax burden or how evenly assets are allocated in society. Instead, it emphasises that the same just processes should apply to everyone equally, and that the mere fact of inequality does not justify taking wealth from one person to give to another if its owner is legitimately entitled to it.

The central weakness of justice in outcomes is that it requires “continuous interference with people’s lives” to ensure that the desired outcome is obtained and then maintained whenever people’s free decisions and actions upset it. It is also a difficult task to decide on an appropriate outcome to direct people to, and an appropriate way to measure that outcome. By contrast, justice in process respects people’s freedom because it treats everyone in the same way and is not concerned to alter their situation so that it conforms to a pattern.

COMPASSION

Having said this, outcomes do become relevant when people are unable to access basic goods such as food or healthcare. Relevantly for tax policy, material hardship and poverty may be a barrier to someone experiencing something vital for life. In order to protect the common good, government may be justified in designing tax (and other) policies to meet this threat of harm, for example by lowering taxes payable by those in need, or by targeting assistance to them through the tax system. This concern for the common good, and therefore those who are in need, gives rise to an obligation of compassion or social justice that rests with individuals and communities around those who are in need. If they are unable or unwilling to assist, the government should then step in. This understanding of the obligation of compassion or social justice differs from an understanding of justice as process.

Where the government does act, it is important that its actions are targeted and limited to meeting the need that justifies them in the first place. This means that redistribution for its own sake, or moves to equalise incomes or wealth that do not relate directly to meeting unmet needs, are unjustified. Measures of relative poverty are the usual way that need is identified in New Zealand, but problems with relative measures have led to suggestions that an absolute measure of poverty would be better because it “emphasises the alleviation of hardship rather than the doubtful objective of making incomes more equal.”

FREEDOM

Discussions about the relationship between tax and freedom are not exactly commonplace. Nevertheless, tax does place limits on freedom—for example, collecting taxes involves coercion—and given the centrality of freedom to democracy, the impact of tax on freedom is an important issue. For example, as the OECD has commented, “the government has increasingly used the tax system as a tool to deliver on other policy objectives.” It has done this through the increasing use of tax incentives that are designed to affect the way people behave and the choices they
make. The implications for freedom are much more subtle than outright prohibitions or commands—such as the command to pay taxes in the first place—but they are real nonetheless.

Of course, freedom must be subject to some limits, otherwise anarchy would result. For example, the requirement to pay taxes to fund government to do what it should is a reasonable limitation of freedom. To understand whether particular limits are reasonable, it is necessary to begin with an understanding of why freedom is valuable, what it is and how it should be limited.

Freedom is a reflection of the dignity of each person as a thinking, acting moral agent. Most importantly, it treats people as ends, not means. It allows people to associate together and to pursue the common good in the way that they choose, and gives scope for their self-development and improvement.

This discussion paper proposes that freedom is best understood as the absence of coercion. That is, people are free when they are not controlled by another person to further that person’s ends rather than their own.\textsuperscript{11} This freedom should be limited by reference to what will harm the common good, to avoid acting in a way that undermines the basic goods that are good for all people and that damages the social fabric. People should be primarily responsible for restraining their actions so that they do not harm the common good, but if they are not responsible, government has a role to play in limiting freedom to prevent that threat of harm.

**POLICY IMPLICATIONS**

Consideration of the fundamental concepts of justice, freedom and compassion points to several concrete conclusions about current tax policies. It casts doubt on the use of policies that attempt to adjust people’s outcomes where this is unconnected to genuine material need. Tax incentives can also be queried for their effect on freedom, as they attempt to direct people’s behaviour. Collecting taxes to spend in ways that do not protect the common good from harm can also be questioned. Similarly, high levels of taxation are problematic as they tend to increase reliance on the government and decrease people’s ability to provide for themselves. Neutral consumption taxes like Goods and Services Tax (GST) may be a better way of raising revenue while respecting justice and freedom.

Current tax policy paints an overall picture of increasing limitations on justice and freedom. This is due in particular to increases in the progression and level of taxation, the growing reliance on tax incentives and the priority given to outcomes such as increased income equality. Different policy directions may do a better job of reconciling justice, freedom and compassion. It is not the purpose of this discussion paper to propose alternative policies—that is a subject that will be taken up in a later paper in this series—but the discussion here suggests that alternative policy directions worthy of further investigation might include:

- **a.** lower taxes that allow individuals and families to keep more of what they have earned;
- **b.** flatter taxes that treat people more equally and reduce the possibility of the tyranny of the majority;
- **c.** altering the tax mix to prefer consumption taxes to a greater degree and income taxes to a lesser degree than at present;
- **d.** strict assessment of tax policies to see whether they are actually necessary and effective to protect the common good from harm;
- **e.** fewer measures designed to direct people’s behaviour and the devolution of greater responsibility to individuals and communities;
- **f.** the adoption of an absolute measure of poverty, rather than a relative one, in order to better identify those in genuine need.

Policy directions like these must be accompanied by individuals and communities assuming greater responsibility for their well-being and the well-being of those around them, to the point of personal sacrifice. If successful, this cultural change will enhance the flourishing of individuals and communities, strengthening the social fabric and the common good.
ENDNOTES

4 N. Johnson, “‘Working for Families’ in New Zealand: Some early lessons,” (Fulbright New Zealand, 2005), 17.
SECTION 1
Introduction to Tax, Justice and Freedom

Working for Families, different tax brackets for different levels of income, interest-free student loans, daycare subsidies, KiwiSaver incentives—the decisions we make are constantly moderated and influenced by the way we are taxed and the way our taxes are spent, raising important issues of justice and freedom. For example, a parent considering a job offer with extra responsibility and higher pay will be influenced not just by the extra tax they will pay on the extra income, but by the Working for Families payments they may lose. Their partner, deciding whether to return to paid employment, will weigh up the costs of daycare and how those costs are reduced by subsidies from the government. At the same time, the taxes they both pay fund the building of the roads they drive on and the police force that keeps them safe.

Deciding how to tax, what to tax and how to spend the money are issues that all democratic governments have to grapple with. These are not easy decisions, and they bring up difficult questions about the appropriate level of taxation, how much of their own money people should keep, and the things that the government should do on behalf of its citizens. The answers to these questions will depend on the view that is taken of the government’s role, the way society should look, the way people should be treated and the amount of responsibility they should have.

The first discussion paper in this series considered how the role of government could be understood, and the implications for taxation. It proposed that the government’s role is to protect the common good from threats of harm where to do so is consistent with proper custom and tradition and respects the principle of subsidiarity. It concluded that this provides the yardstick for government action and therefore for taxation to fund those activities. This discussion paper continues the series by taking up the questions about the way society looks and the way people are treated and act, and asking what they mean for tax. These questions are usually answered by theories of justice and compassion, freedom and responsibility.

Justice and freedom are recognised as hallmarks of democracy, and compassion and responsibility as integral to a decent society. Together they facilitate good government and a flourishing society, making them central to the common good. A sense that taxes are just and fair, for example, is more likely to lead to willing compliance with tax laws than if citizens believe they are paying more than their fair share. In other words, if we believe that justice is upheld we are more likely to be engaged and responsible citizens. If we feel that we are treated fairly, then we are more likely to obey the law and to feel a sense of moral obligation to our fellow citizens and a sense of public service to our community.

Issues of justice or fairness begin to be raised when, for example, we discuss the tax burden. What should we make of figures that show that in the 2008–2009 income year, the top 5 percent of income earners will pay 29 percent of the total collected from personal income tax, while the bottom 78 percent will pay 34 percent of that total? Of course, those with more should pay more in tax—but how much more, and how should that be determined? Where does the distribution of taxpayer-funded assistance, like Working for Families, sit alongside this? “[A] round three quarters of New Zealand families with children” are receiving Working for Families tax credits which currently amount to around $2.7 billion. Are redistributive programmes the best way to express compassion and ensure that those experiencing genuine hardship and need are looked...
after, and are they consistent with the concept of justice? What should be made of the increasing use of tax incentives to direct people's behaviour? This is a trend that poses some subtle, but real, implications for freedom. The OECD has expressed some concern about it, and it seems to represent something of a return to the kind of tax system that New Zealand reformed in the 1980s because it was regarded as "unfair and inefficient."5

This paper proposes that questions like these must be considered in the context of the common good. The common good can be thought of as "the irreducible goods which are good for every person everywhere."7 In other words, the constituent elements of the common good are what allow people to flourish and to live well, individually and in community. They include things like life, knowledge and friendship. These irreducible or basic goods can be expressed and pursued in many ways. Because they are all basic, it is not possible to reduce them down to one good that should be promoted above others. This means that people should have freedom to pursue the common good in the way that they choose, and that it is not possible to prescribe a particular "good life" that everyone should conform to. Recognising this is also consistent with upholding the dignity that people have as thinking, acting moral agents capable of making their own decisions and working out their own plan in life.

As people pursue what they view as good, their interactions necessarily raise issues of justice—that is, issues about whether they treat other people in the right way and act in a way that is consistent with the common good. Questions about the ownership of property and the distribution of resources will arise, and government has a particular responsibility for adjudicating on disputes between its citizens and for maintaining justice.10

At times the common good is challenged. Genuine hardship or need, for example, may prevent people accessing and enjoying the basic goods. To take an extreme example, poverty may endanger the basic good of life through the threat of starvation. Less extremely, poverty may restrict the pursuit and enjoyment of the good of life through inadequate access to health services and decent food. Where this is the case, the imperative to protect the common good may require individuals and communities to care for those in their midst who are in need and, if they are unable to meet that need adequately, it may require government to take steps to prevent the harm to the common good represented by that unmet need. This concern for those who are not able to access or enjoy the elements of the common good can be described as a moral obligation of compassion, to distinguish it from issues of justice and freedom. At times, justice, freedom and compassion will conflict, as when government requires its citizens to pay taxes to fund social welfare programmes. Deciding what the appropriate limits are on each of these things depends on what is necessary to protect the common good.

Questions about taxation should therefore be seen as part of this larger picture. Debates over justice or fairness in taxation, how to design tax and spending to take account of need, and the use of the tax system to direct people's behaviour are all current issues that fit within this framework. However, the debate about these things is not always particularly clear or illuminating. "Fairness" seems to mean different things to different people—for example, steeply progressive taxes are regarded as fair by some, while proportionate or flat taxes are viewed as fair by others. Tax measures apparently designed with some view of fairness in mind—a view that prioritises redistribution and equal outcomes—are often automatically regarded as just and compassionate, without asking whether this is appropriate. The relationship between tax and freedom is not often discussed. It is therefore important to examine what concepts such as justice, compassion and freedom actually mean, in order to understand how they relate to each other and to the common good, and what they tell us about the shape of tax policies.

One of the main ways that justice in taxation is pursued is through progressive taxation of personal incomes, where higher earners pay a larger proportion of their income in tax than lower earners. Progressive taxation is intended to redistribute income and bring about greater income equality, and concerns about inequalities in income and wealth are often the subject of public and political comment. But are these and other measures of tax justice consistent with a proper understanding of justice?

This discussion paper will suggest that views about justice can be divided into two schools. The first measures justice by the outcomes it produces, such as the way that resources are distributed in society, and whether they are distributed equally. The second measures justice by the processes that are applied to
people and their property—that is, whether people are treated equally and impartially regardless of the way that resources are distributed. It will go on to suggest that justice is best understood in terms of processes; that is, it is not unjust if the distribution of resources in society is unequal, or does not fit some other favoured pattern. What is important for justice is that people are treated equally and that the legitimate ownership of property is respected, a position which gives appropriate recognition to the value and importance of freedom. It suggests that tax policies that attempt to impose some sort of outcome or pattern on individuals and on society, like greater income equality, are incompatible with the freedom that is necessary to allow people to pursue the common good in the way that they see fit. This is despite the view which is sometimes expressed, that differences between “the rich” and “the poor” indicate injustice. Instead, on this understanding of justice, such differences would only be unjust if the wealth of “the rich” somehow caused the poverty of “the poor.”

While this view of justice suggests that tax policies that attempt to direct society to some sort of outcome are not justified on justice grounds, justice does not stand alone. As has been discussed, the common good also requires compassion for those who are not able to access or enjoy it, and this may provide a role for tax policies that are designed to overcome that disadvantage. It certainly requires individual and community action to assist those who need help, an obligation that may be described as one of “social justice” or “attributive justice.” It is also important to consider whether responsibility for meeting these needs rests in the first place with government or with the community, and who can most effectively respond to need. Tax policies may be compatible with compassion, even if they are not with justice, when there are legitimate grounds for the government to act and when those policies respond to genuine hardship and need. Policies designed with different objectives in mind—for example, to make people’s material wealth more equal regardless of need—do not meet this test.

Tax policies that are designed to pursue particular outcomes, like redistribution, have implications for freedom as well as for justice. This is because compulsorily acquiring people’s resources in order to transfer them to others and to fund the achievement of social policy goals prevents people from doing as they like with assets that they legitimately own. It also reduces the freedom that is necessary to allow people to pursue the common good in their own way and on their own terms. And, of course, paying taxes is compulsory, which is a further limitation of freedom. There may be good grounds for these limitations—for example, the government must be funded to perform its legitimate role—and freedom must always be subject to some limitations to protect the common good and to allow people to live together in harmony. Limitations to freedom are a fact of life and are not arbitrary; they reflect the real world that we live in, a world of human interconnection which requires government to have certain responsibilities and perform certain functions that enable us to live together in peace and security. But this does not mean that any and all limitations of freedom are justified. Particular tax policies should be reviewed to see whether they are consistent with a proper understanding of freedom and, if they limit that freedom, whether that limitation is justified by reference to the common good.

This discussion paper proposes that freedom is best understood as the absence of coercion, or non-interference. This view holds that freedom depends on relationships between people, and whether one person is forced to act against their will by another. It is therefore different to other prevailing accounts which see freedom as depending on whether someone has the resources and abilities to achieve their goals.

However, defining freedom in this way should not be taken to mean that there are no constraints on the way freedom can be used, or that taxation should be abolished because it limits freedom. Rather, freedom is not, and never can be, absolute. Society will not function if it is. Instead, freedom can, in the language of the New Zealand Bill of Rights Act 1990, be subject to “justified limitations” and taxation certainly can be a reasonable limitation in principle as it is needed to fund government to do what it should. It allows government to respond to threats to the common good and contribute to the conditions that allow society to flourish, for example by ensuring peace and security. But it cannot be assumed that every tax policy is a reasonable limitation of freedom. Limitations must be demonstrably justified if they are to be acceptable.

This paper proposes that the justification for limiting freedom is that it should not be used in ways that harm the common good. Individuals should
therefore be responsible in their use of freedom, so that their actions do not create a threat of harm to the common good that requires government intervention to prevent damage to the social fabric. The limitations of freedom involved in government intervention should be avoided as much as possible, because of the value of preserving freedom. Freedom reflects the dignity that people have as thinking, acting moral agents, a dignity which exists no matter how poorly that freedom is used. Freedom allows each person to flourish on their own terms. It also allows them to associate with others to pursue common ends, and a society composed of strong, free associations is well equipped to resist unwarranted attempts by the government to restrict freedom.

Section 2 of this discussion paper will begin by considering theories of justice and fairness, going on in section 3 to ask how justice and compassion should be understood. It will then consider how freedom should be understood and limited in sections 4 and 5. The paper concludes by looking at the implications of these discussions for tax policy in section 6. Issues of fairness and justice are often raised when changes to the tax system are being considered, almost as though the status quo is presumptively fair, but this paper will ask how current policies measure up against the proposed views of justice, compassion and freedom. It is not the purpose of this paper to propose alternative policies—that will be the subject of a later paper—but some general directions for policy can be discerned from the discussion in this paper.

As the noted tax theorist Richard Musgrave said, “The duty to pay taxes, or the power to tax, is among the most tangible of all links between subject and sovereign, or citizen and society.” Tax policy must take many things into account, such as the role of government and community, and broad philosophical and moral issues, such as its relationship to the common good—justice, freedom and equality. It must also take account of more purely economic and practical issues, such as administration and compliance costs and sheer revenue necessity. Only if it is grounded firmly on a proper understanding of the common good, the role and responsibilities of government and community, and the principles of justice and freedom can it treat these often competing priorities appropriately.

TAX AND JUSTICE IN NEW ZEALAND

New Zealanders attach great importance to everyone having a “fair go,” though exactly what this means is not always very clear. Fairness in taxation has been given a prominent place in recent Government policy. The Minister of Finance, in his Budget Policy Statement 2008, committed to personal tax reform that is “consistent with our overarching goals by focusing primarily on fairness ...” This meant, among other things, that the Government "will cut taxes in a way that does not lead to greater inequalities in our society."14

The Tax Review 2001 (“McLeod Review”), the most recent report into “the architecture of our tax system,” stated in its Issues Paper that: “In broad terms, the key focus of tax policy is to enhance the overall economic well-being of New Zealanders by seeking ways to reduce the costs of imposing taxes ... while promoting fairness and continuing to raise sufficient revenue.”15

In its subsequent Final Report, the Review proposed a similar formula: “The two objectives of the personal income tax are to generate revenue for the government and reduce income inequality. This raises the difficult question of how the income tax rate scale should be designed to collect the required revenue efficiently while contributing to income redistribution.”16

Others hold a similar view of the purpose of taxation. For example, the Child Poverty Action Group considers that “The way tax is gathered is only one mechanism for achieving a fairer distribution of income, but it is a very important one. The tax system has become far less successful in apportioning the tax burden equitably, and can be held responsible for a good part of New Zealand’s rapid growth in inequality ....”17

Everyday assumptions about taxation and justice are generally consistent with these statements. It seems that many New Zealanders hold the view that fairness is important in tax policy, and that reducing income inequality and redistributing incomes are intimately connected with notions of what is fair. Half of the New Zealand respondents to an international survey on the role of government in 2006 believed that “the government should reduce income differences between the rich and the poor.”18 There also seems to be general acceptance of the idea that “the rich” should pay more in tax because they
are able to, or because it will cause them less pain in doing so. Speaking after the delivery of Budget 2008, the Prime Minister stated that the package it implemented was fair “because those who are the lowest earners benefit the most—and that is the way it should be under any Government.”

The focus of the fairness debate is often, though not always, on personal income tax. This is not surprising, both because it is the largest single component of core Crown revenue, making up 44 percent of the total, and given the assumptions about fairness built into its progressive structure.

Progressive income taxation is one of the primary tax mechanisms for achieving desired fair outcomes, reducing income inequality and redistributing income. This is because personal income taxes take a greater percentage of higher earners’ incomes than they do of lower earners’ incomes. That is, the amount of tax that must be paid increases progressively as income increases.

The McLeod Review noted that “many New Zealanders value the progressivity delivered through the tax system.” Some obviously value it extremely highly, alleging “an urgent need to reform the income tax structure to make it more progressive” to counter income inequality, among other things.

The effect of progressive taxation can be seen in the table from the Treasury, below. It reveals that, in the current financial year, the top 5 percent of taxpayers will pay 29 percent of the total personal income tax, while the bottom 78 percent will pay 34 percent.

It is also important to look at how the public services funded by these taxes are distributed. Data from the McLeod Review (Figures 1.1 and 1.2) reveals that much of the benefit of tax-funded spending goes to those who pay the least tax, and that many households are getting more in public services than they are paying in tax. The graphs compare “The amount of tax paid under the [then] current progressive scale and under a [hypothetical] proportional rate of 25 percent.” As the authors of the Review note, “Significant income redistribution takes place. The households that have the lowest market incomes pay the least tax but receive the greatest direct benefit from government spending.”

So, for example, while the top 5 percent of taxpayers will pay the greatest percentage of personal income tax, they will also get the smallest proportion of the approximately $2.7 billion to be spent on Working for Families’ Family Support and In-Work Tax Credits in each of the next two years.

Against this background, we should examine what is “fair” taxation. Although equality, redistribution and progression are important in this discussion, as seen from the citations above, they do

### Table 1.1. Who pays income tax and how much?

<table>
<thead>
<tr>
<th>Annual individual taxable income ($)</th>
<th>Number of people (000)</th>
<th>Tax paid ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero</td>
<td>239</td>
<td>0</td>
</tr>
<tr>
<td>1 - 10,000</td>
<td>442</td>
<td>248</td>
</tr>
<tr>
<td>10,000 - 20,000</td>
<td>841</td>
<td>1,968</td>
</tr>
<tr>
<td>20,000 - 30,000</td>
<td>372</td>
<td>1,592</td>
</tr>
<tr>
<td>30,000 - 40,000</td>
<td>339</td>
<td>2,191</td>
</tr>
<tr>
<td>40,000 - 50,000</td>
<td>314</td>
<td>2,895</td>
</tr>
<tr>
<td>50,000 - 60,000</td>
<td>225</td>
<td>2,814</td>
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<tr>
<td>60,000 - 70,000</td>
<td>146</td>
<td>2,338</td>
</tr>
<tr>
<td>70,000 - 80,000</td>
<td>112</td>
<td>2,204</td>
</tr>
<tr>
<td>80,000 - 90,000</td>
<td>58</td>
<td>1,372</td>
</tr>
<tr>
<td>90,000 - 100,000</td>
<td>35</td>
<td>965</td>
</tr>
<tr>
<td>100,000 - 150,000</td>
<td>87</td>
<td>3,217</td>
</tr>
<tr>
<td>150,000 +</td>
<td>51</td>
<td>4,569</td>
</tr>
<tr>
<td>All</td>
<td>3,261</td>
<td>26,373</td>
</tr>
</tbody>
</table>

This table includes tax on New Zealand Superannuation and major Social Welfare benefits, but excludes ACC levies and anyone who is under 15. Data are projected for the year ended March 2009 and include the changes to tax rates and thresholds on 1 October 2008.

not exhaust the field of relevant issues. From time to
time, discussion of other, “fairer” policies crops up,
such as a proportionate or “flat” tax (where everyone
pays the same rate of tax on all their income), or a
tax-free bracket of income and a flat rate of tax on
all income above that bracket (which is, in effect, a
progressive tax).

Section 2 of this discussion paper will, therefore,
examine more closely what fairness, or justice, in
taxation involves. As the literature on the subject of
taxation and fairness is vast, attention will be confined
to that part of it that is relevant to issues current in
New Zealand. The policy implications of this view of
tax justice will be considered in section 6.

TAX AND FREEDOM IN NEW ZEALAND

Freedom and justice are closely linked, as will be
made clear by the discussion in section 3. Freedom
is also a vitally important subject in its own right.
However, tax and freedom are not discussed much these days. Instead, the conversation focuses on justice issues like equality and redistribution, and there is almost a sense that invoking concerns about freedom, or suggesting that it is being eroded in any way, is alarmist. In a way, this is not surprising. In a country that has been peaceful and prosperous for over a century, it is easy to take for granted the freedom that is a crucial foundation for that peace and prosperity, and to forget the historical concerns about the way that tax can limit freedom.

One purpose of this discussion paper, therefore, is to examine the relationship between taxation and freedom and to understand the limits that tax may appropriately place on freedom. So how does the modern tax system in New Zealand involve issues of freedom?

First, and most obviously, paying tax is not a voluntary exercise. Tax is collected by compulsion, and penalties await those who do not comply with the tax laws. The taxes that are collected are used to fund a range of government activities, ranging from functions that are unarguably core to government, such as the maintenance of law and order, to activities designed to achieve social policy goals, such as childcare subsidies intended to make it easier for parents to take up paid employment. Regardless of whether taxpayers use the tax-funded services provided by government or agree with the goals, they must contribute their taxes towards them.

The compulsory payment of taxes thus contributes indirectly to the achievement of government social policies, by providing the funds for those policies. It also contributes more directly, as it is intended not only to raise revenue for the government, but also to implement greater income equality and "fairness." It does this through progressive taxation and redistribution; effectively, taking more from some in order to give more to others, in accordance with a vision of distributive or socio-economic justice and a favoured pattern of resource allocation in society. The progressive taxation of personal income is therefore explicitly designed to forcibly redistribute wealth between citizens, to compel some to give up a greater share of their income than others. The attempt to shape people’s outcomes, and to make their after-tax incomes more equal, involves obvious limitations on freedom. As economist Larry Reed rather pithily puts it, "Free people are not equal, and equal people are not free." Of course, actually making people equal would require a much more progressive tax system than New Zealand’s. Nevertheless, moves in the direction of greater equality of incomes involve corresponding restrictions of freedom.

The attempt to achieve distributive justice also opens the tax system up to the possibility of the tyranny of the majority. If governments can tax different groups of citizens differently, then those writing tax laws wield a great deal of power, including the power to limit the freedom of a minority for the benefit of a majority by taxing them more heavily. A vivid recent illustration of this danger comes from the 1999 general election, where the Labour Party “had gone to the electorate promising to spend more money on everyone and had explicitly told 95 per cent of income earners that they would have to pay nothing extra for it. Only a small minority of voters, those earning more than $60,000, would pay a new top marginal rate” of 39 cents in the dollar. Labour won the election and the rest, as they say, is history.

The selection of income as a tax base also has implications for freedom. Tax can be levied on a variety of sources or bases, such as income, consumption (spending), inheritance (in the form of death duties) or imported goods (in the form of customs duties and excise). Personal income is a significant part of New Zealand’s tax base, making up 44 percent of core Crown revenue. GST, a consumption tax, is the next biggest source of revenue, at 19 percent. The issue that income taxes pose for freedom is that they require taxpayers to reveal their financial affairs to the government for the assessment of tax. Consumption taxes, by contrast, do not. On the introduction of income tax in Britain, one rather displeased citizen made the point in this way: "[The income tax] is a vile, Jacobin pumped up Jack-in-the-Office piece of impertinence—is a true Briton to have no privacy? Are the fruits of his labour and toil to be picked over, farthing by farthing, by the pimply minions of bureaucracy?" As might be expected, intrusive forms of taxation have never been popular. The hearth tax introduced in Britain in 1660 required tax collectors to enter private homes to count the number of hearths, and so was described as "a badge of slavery." It was eventually replaced with, among other things, a window tax, which did not pose the same issues as tax collectors could count windows.
Although income taxation seems to have always been a permanent fixture in our landscape, it only acquired this status comparatively recently. The tax historian Charles Adams records that the very first income tax was imposed in 1404, but it appears to have been short-lived, and all records of it were destroyed; "the tax was to be kept concealed from posterity because it was such an evil."\textsuperscript{34} Modern income taxation began in 1799 in Britain, as a means of raising revenue to fight the Napoleonic wars, and it was repealed after those wars in 1816. However, it was reintroduced in 1842 at a flat rate of 3 percent and proved so effective at raising revenue that it has remained in force ever since, though at somewhat increased rates.\textsuperscript{35}

In New Zealand, income tax was introduced by the Land and Income Tax Assessment Act 1891. Under this Act, "individuals earning less than £300 per annum were exempt. Income between £300 and £1,000 paid 2.5 per cent; income over £1,000 paid tax at 5 per cent. Income tax for companies was a flat 5 per cent."\textsuperscript{36}

Regardless of the form of taxation, the slogan "no taxation without representation" has influenced tax debates for centuries. It expresses something important about the relationship between those who impose tax and those who must pay it, guarding against oppressive use of the revenue-raising power. New Zealand has inherited the legacy of the historical contest which established this principle. The result of this contest between Parliament and the King was the principle that the Crown's power to impose taxes is checked by the requirement that the people must consent to taxation through their representatives in Parliament. The principle took effect in Article 4 of the Bill of Rights 1688, which provides "That the levying of money for or to the use of the Crown by pretence of prerogative without grant of Parliament for longer time or in other manner than the same is or shall be granted is illegal." This provision became part of New Zealand's law in 1840 and has also been expressed in the Constitution Act 1986.\textsuperscript{32} The issue of consent to taxation was, of course, a trigger for America's War of Independence against Britain. Colonists objected forcefully to being subject to taxes while also being deprived of "the rights ... of Englishmen" to consent to taxes, rights supposedly secured to them under colonial charters.\textsuperscript{38} The doctrine continues to bear on New Zealand politics, as shown by recent debates over the retrospective validation of the use of public money for electioneering purposes,\textsuperscript{39} and by its use to partially justify attempts to lower the voting age to 16.\textsuperscript{40}

The level of taxation is also regarded as an important element of economic freedom. The annual \textit{Index of Economic Freedom} published by the Heritage Foundation and the Wall Street Journal measures ten "economic freedoms" and ranks countries accordingly. The economic freedoms include "fiscal freedom" (the level of taxation) and "government size" (measured by the ratio of government expenditure to GDP). In the 2008 edition, New Zealand was ranked sixth in the world for economic freedom, but scored lowest on fiscal freedom and government size, due to our "high tax rates" and high levels of government expenditure.\textsuperscript{41} New Zealand's scores in those two categories were below the global average, but above the global average in all the other eight categories.\textsuperscript{42} The significance of economic freedom is that there is a "strong relationship between the level of freedom and the level of prosperity ... 14 years of Index data strongly suggest that countries that increase their levels of freedom experience faster growth rates."\textsuperscript{43}

Finally, and most interestingly, the tax system has implications for freedom because of the increasing reliance on it to achieve social policy goals, not just by redistributing income, but by incentivising certain types of behaviour. Some obvious examples are the tax credits attached to the KiwiSaver superannuation scheme to encourage retirement saving, the recent changes to the charitable tax regime to encourage charitable giving, and the Working for Families tax credits which are intended to encourage work. These changes have been seen by some as the beginning of a return to a tax regime that was thoroughly reformed in the 1980s.

The McLeod Review considered that the tax regime existing at the beginning of the 1980s was regarded as "unfair and inefficient" because it was narrowly based. "One of the main reasons for the narrow base was the provision of incentives or concessions for activities seen as having social or economic merit." The tax system of that time was "increasingly unable to meet the government's revenue requirements."\textsuperscript{44} Although tax rates were often higher than they are now—the top rate of personal income tax was 66 percent in 1982—the existence of a number of exemptions meant that the
actual amount of tax paid was often significantly lower than the rates would suggest. Some groups also bore a disproportionate share of the tax burden; “because of pervasive tax concessions for the self-employed and companies, most of the tax burden fell on employees.” This “narrow base, high rate” system was reformed in the 1980s into a “broad base, low rate” system, designed to spread the tax burden more fairly, reduce opportunities for avoidance and to be more efficient. Perhaps the most significant way the tax base was broadened was by the implementation of GST. The reduction in rates was made possible by the abolition of the concessions.

Even though the transformation was a success, the McLeod Review noted that some submitters to the Review in 2001 favoured “greater use of tax concessions and penalties to achieve social or economic objectives.” The Review went on to say:

> There did not seem to be an appreciation among the submissions favouring the greater use of tax concessions that this inevitably narrows the tax bases. Over time this may lead back to the 1981 model, for which there is, in our view, little support. For example, while tax concessions for superannuation were supported by some, 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 percent.

Despite the Review’s warning, the use of concessions and incentives is back in favour. Although such policies do not involve outright prohibitions or commands, they nevertheless mould and shape people’s actions, structuring their choices by attempting to affect their decisions and guide them to a defined goal. The implications for freedom are subtle, but that does not make them any less real.

Tax, therefore, unquestionably limits people’s freedom. Equally unquestionably, freedom is not absolute and can be justifiably limited. To understand whether any of these particular limitations are justified, it is necessary to understand why freedom is valuable—considered below—and what it is—considered in sections 4 and 5. Only then is it clear what the limitations put at stake.

**Why is freedom valuable?**

Freedom is valuable for many reasons. To begin with, it is fundamentally a reflection of the dignity that each human being has. Humans are thinking, acting moral agents, with the ability to plan their own course in life and work out their own purposes. Social commentator David Green believes that freedom is entailed by an understanding of people “not as role players under leadership but as intelligent agents ... guided by beliefs, choices, sentiments or habits.” Freedom viewed this way “is central to the dignity of men and women.”

The importance and value of freedom can also be understood by imagining its absence. Without freedom, people become pawns in someone else’s game, resources to be exploited to enable those who limit others’ freedom to implement their goals and plans. This is what led the economist and philosopher Friedrich Hayek to say that “Coercion is evil precisely because it thus eliminates an individual as a thinking and valuing person and makes him a bare tool in the achievement of the ends of another.”

Freedom is also valuable because it allows us to associate in community with each other. This liberty to associate allows the formation and flourishing of “associative communities” such as charities, clubs, societies and churches. A network of strong associative communities is an essential part of a strong social fabric. Seen in this way, freedom is not just valuable on an individual level, but also for the way it allows people to come together for common ends and to pursue the common good.

A strong civil society, composed of flourishing associative communities, not only counters the modern tendency to individualism, but is also an important check on the extension and abuse of government power. Of course, the government has an important role to play in the preservation of freedom, for example by maintaining the legal frameworks necessary for security of the person and of property. But as the holder of “a monopoly of coercion, the government is also a potential menace to liberty.” If the government attempts to extend its monopoly of coercion to absorb the role and responsibilities of others in society, a strong network of associative communities is able to push back and resist the attempt, acting as “a bulwark against the growth of the state.”

Samuel Gregg notes that the celebrated political thinker Alexis de Tocqueville believed that:

> [a] socially atomized society ... was much less capable of forming the associational bonds that allow people to restrict unwarranted
extensions of State power. Part of de Tocqueville’s proposition for pre-empting soft despotism was the cultivation of a plethora of free associations between the State and individual persons. The activities of these groups—what Edmund Burke famously described as ‘little platoons’—would help to repair the social links damaged by the ongoing democratic demand for submission to the majority. The same plurality of self-organized and interactive associations would teach people how to engage with others outside their families and help them to acquire the moral habits required by citizens in a democratic order, especially if this society was not to be obsessed with equalizing everything. This would eventually facilitate the emergence of what de Tocqueville called ‘the independent eye of society’ to inform and moderate democratic processes.

Freedom also allows us to flourish on our own terms, to choose the conception of the good life which appeals most to us. The anti-materialist organic farmer is not forced to wear a suit and practice commercial law, for example. Freedom allows people to experiment with new ideas and activities, to discover new and improved ways of doing things. Hayek, for example, believed that coercion should be limited to ensure freedom because this will, “on balance, release more forces for the good than for the bad,” aiding progress and prosperity.55 This should not be taken to mean that something is good just because it is “progress,” or that all conceptions of the good life are, in fact, good. “Progress” may have quite destructive results, and a psychopath’s conception of the good life is repugnant. This serves to emphasise the need for freedom to be limited in some way, a topic discussed further in section 5. Nevertheless, the potential of freedom can be contrasted with the debilitating effects of the coercive, centralising impulse manifested in communism, which results in “economic stagnation, political repression, and widespread corruption.”56

Finally, freedom gives us the scope for self-development and improvement. As the philosopher John Stuart Mill said in his famous essay, On Liberty, “The mental and moral, like the muscular powers, are improved only by being used.”57 Freedom allows us to use those powers, which Mill believed to be an essential element of our “mental education.”58

ENDNOTES

1 S. Thomas, “Governing for the Good: What does it really mean?” (Auckland: Maxim Institute, 2008), 25-26. “Subsidiarity grants a circumscribed role for government to come to the aid of individuals and communities when they cannot protect themselves.”


8 S. Thomas, “Governing for the Good: What does it really mean?” 75.


10 S. Thomas, “Governing for the Good: What does it really mean?” 54.


20 M. Cullen, “Budget 2008: Key Facts for Taxpayers.”


23 This calculation follows the analysis in S. Davidson, “Personal Income Tax in New Zealand: Who pays and is progressive taxation justified?” (Wellington: New Zealand Business Roundtable, 2005), Table 4.


For example, in his speech introducing Budget 2005, the Minister of Finance stated that increased spending on "Out of School Care and Recreation, childcare and related initiatives" was intended "[t]o enhance the choices parents have to participate in the labour market." There is an important question about the extent to which government should be involved in increasing the range of choices open to some, using money acquired from others who may not agree with the policy and who do not have those choices made available to them. See M. Cullen, "Budget Speech" (Wellington: The Treasury, 2005), 15.


C. Adams, For Good and Evil: The impact of taxes on the course of civilization, second ed., (Lanham, Maryland: Madison Books, 1999), 258. The window tax had the side effect of encouraging taxpayers to fill in existing windows, or build windowless rooms, to reduce their tax liability.

C. Adams, For Good and Evil: The impact of taxes on the course of civilization, 345, citing the historian Thomas Walsingham.

C. Adams, For Good and Evil: The impact of taxes on the course of civilization, 349-353.


M. Cullen, "Budget 2008: Key Facts for Taxpayers,"


C. Adams, For Good and Evil: The impact of taxes on the course of civilization, second ed., (Lanham, Maryland: Madison Books, 1999), 258. The window tax had the side effect of encouraging taxpayers to fill in existing windows, or build windowless rooms, to reduce their tax liability.

C. Adams, For Good and Evil: The impact of taxes on the course of civilization, 345, citing the historian Thomas Walsingham.

C. Adams, For Good and Evil: The impact of taxes on the course of civilization, 349-353.

P. Goldsmith, We Won, You Lost. Eat That! A political history of tax in New Zealand since 1840, 80.

P.A. Joseph, Constitutional and Administrative Law in New Zealand, third ed., (Wellington: Brookers, 2007), 493-495. Section 22 of the Constitution Act 1986 provides that: "It shall not be lawful for the Crown, except by or under an Act of Parliament—(a) To levy a tax; or (b) To borrow money or to receive money borrowed from any person; or (c) To spend any public money."

C. Adams, For Good and Evil: The impact of taxes on the course of civilization, 301-302.

In 2006, the Auditor-General found that various political parties had used public funding for election campaigning purposes at the 2005 general election. The funds had not been authorised for this use by Parliament—instead they had been approved for "parliamentary purposes"—so the Treasury recommended retrospective legislation consenting to their use for electioneering, in order to uphold the principle of Parliamentary control of revenue and expenditure. The issue aroused strong public feelings and opposition to the legislation.

Sue Bradford MP of the Green Party proposed a Civics Education and Voting Age Bill which would lower the voting age from 18 to 16. The Bill’s explanatory note states that it is required because those under 18 "may well be in full time paid employment. Under the current age for electoral registration, such young persons are paying tax on what may be quite substantial full-time earnings, but have no ability through Parliamentary representation to elect those who determine both the level of income tax and other taxes they pay or the manner in which the tax revenue collected from them is expended."


S. Thomas, "Governing for the Good: What does it really mean?" 63.

D. Green, From Welfare State to Civil Society, 54.

S. Thomas, "Governing for the Good: What does it really mean?" 63.

S. Gregg, On Ordered Liberty, (Lanham, Maryland: Lexington Books, 2003), 93.


S. Gregg, On Ordered Liberty, 33-34.


Fairness can be a rather elusive concept. At various times it can mean entirely different, even contradictory things. Often the underlying meaning is assumed and not spelt out, either because it is convenient to be vague or because it is simply thought that everyone shares the user's view of what is fair. As a result, the potential for misunderstanding and subjectivity is high. Despite this, "fairness" and "justice" are invoked freely in tax debates.

Conceptions of justice involve questions about what is good and what is the right way to act. It goes without saying that functions of government, such as the creation of laws and their enforcement, and the levying of taxes, involve issues of justice. When government acts, we expect it to act justly. Private citizens should also act justly—for example, they should not help themselves to their neighbour's property—but they are often quite properly motivated by different considerations as well. Someone might give groceries to a neighbour not because justice imposes an obligation on them to do this, but for reasons of altruism or compassion. This discussion paper will suggest that these motivations and obligations of compassion and decency between citizens do not involve issues of justice, as that term is properly understood. Although some specific uses of the term "justice" (such as attributive and social justice) do have a broader meaning and include moral obligations of compassion, it is important to distinguish them from justice in its strict sense. It is this strict or proper sense of justice that provides a primary justification for legitimate government action and, therefore, legitimate taxation.

Justice is also a very powerful concept, as it creates entitlements and legally enforceable obligations. If, for example, it is thought that justice requires redistribution of resources from the "haves" to the "have nots," there will be an enforceable entitlement on the part of the "have nots" to some of the property of the "haves."

With this in mind, it is important to spell out the competing conceptions of justice in taxation so that they can be analysed and critiqued. This is not just an academic exercise; committing to one conception rather than another makes a real difference to tax policy and therefore to the level and distribution of after-tax incomes. For example, if redistribution to achieve more equal outcomes is thought to be fair, progressive tax rates will probably be endorsed, benefitting some at the expense of others.

So what is the appropriate yardstick for fairness? One of the most significant divisions in theories of justice depends on whether fairness or justice is measured by giving priority to achieving certain outcomes and pursuing "the good," like equal distribution of resources, or by giving priority to following certain processes and acting rightly, such as not taking property off someone that they have gained in a legitimate way. The debate about outcomes and processes is not—or not merely—a technical one. It depends on views about background moral issues. For example, those who favour a focus on outcomes often say that the level and distribution of wealth depends on "arbitrary," unearned factors such as natural ability, being born into a family that teaches the values of hard work and education, and sheer luck. As there is no legitimate entitlement to these factors, they say, any wealth that results from them is similarly unearned and undeserved and can be taken and used by society to benefit those unfortunate enough to be born without those factors. By contrast, those who favour a focus on processes will say that wealth and income depend heavily on personal decisions and choices, and the
use that is made of inherited ability. If someone chooses to work hard rather than to maximise their leisure time, no-one else has an entitlement to the fruits of their labour. Nor is there any justification for taking money from someone just because society chooses to reward their skill set more highly than the skill sets of others.

Many of the so-called “traditional criteria” of fairness in taxation are outcomes-focused: vertical equity, the benefit principle, ability to pay and equality of sacrifice. However, horizontal equity, another traditional criterion, is process-focused. The outcomes approach is consistent with concerns for distributive justice, while the process approach embodies insistence on respect for personal integrity, moral desert and equal treatment by the law or “formal equality.”

Robert Nozick is one of the best-known exponents of a theory of justice in process. His position can be summed up in the statement, “Whatever arises from a just situation by just steps is itself just.” His approach is distributionally neutral. In other words, on his view justice does not depend on how assets or opportunities end up spread across society, but on adherence to correct processes of acquisition and transfer. John Rawls, on the other hand, is one of the best-known exponents of a theory of justice in outcomes. While he allows that “social and economic inequalities” may exist, he believes that they may only do so if they are “attached to offices and positions open to all under conditions of fair equality of opportunity” where “they are to be to the greatest benefit of the least-advantaged members of society (the difference principle).”

Clearly, these approaches are incompatible. Justice cannot depend on whether correct processes have been followed, and also on the outcomes that result from following those processes. Either processes or outcomes must predominate. This section will examine how arguments about fairness or justice in taxation play out in this framework, before turning in the following section to consider which of these approaches gives the best account of justice. That will also involve consideration of when a compassionate concern with outcomes is appropriate.

**JUSTICE IN OUTCOMES**

Most theories about what is fair taxation give priority to some favoured outcome as a benchmark. For example, the idea that fair taxes correspond to taxpayers’ ability to pay gives priority to spreading out the tax burden so that it is concentrated on those who have greater means, and are therefore more able to bear the burden. This theory, like those that give priority to sharing out benefits in some way, involves looking at a distribution and so can be called a conception of distributive justice. In these theories, justice depends on how something good, perhaps income, wealth, or welfare, or something onerous, such as the tax burden, is distributed across society. Concern about deviations from desired distributional outcomes will drive public and political actions.

**Ability to pay**

The ability to pay idea is that the tax burden should be distributed according to ability to bear it. Those with more money are required to bear a larger share of the burden than those with less. Recently, the McLeod Review described ability to pay as one of “four general principles of fairness that are usually considered in setting tax policies,” and it is clear that the principle has a long history. Economist Sinclair Davidson notes that the New Zealand Council of Trade Unions believe “tax policy should aim to lift the burden of the greatest contribution to taxation from working people (and particularly the low paid) and to shift it on to those who can afford to pay, ie the wealthy and the corporate sector.” Earlier this year, the democratic socialist Alliance Party described the restoration of “a fair tax system based on ability to pay” as one of its “key goals.” Its alternative Budget would see the top 33 percent of taxpayers paying more tax, and the remaining 67 percent receiving tax relief. The appeal of the ability to pay principle is not confined to the left of the political spectrum. Davidson also documents “The revenue strategy agreed by the National-New Zealand First coalition in 1996 [which] proposed, as an aim of government policy, a tax system that is fair, with all taxpayers making an equitable contribution, based on their ability to pay.”

The ability to bear a tax burden is also described as the ability “to tolerate a sacrifice.” Mill, an advocate of the ability to pay principle, concluded that the principle requires that taxes impose an equal sacrifice on each taxpayer. This was a product of his concern for the importance of equal treatment before the law and, consequently, equal treatment
The notion of equal sacrifice, which appears to be the dominant interpretation of the ability to pay principle, will be considered later in this section. Of course, the ability to pay principle could also be interpreted as justifying unequal sacrifices, and this will be briefly considered here.

To begin with, it seems somewhat arbitrary to say that simply because someone can afford a sacrifice, inflicting it is justified. The economist Joel Slemrod considers that the equal sacrifice approach “does not point to a particular relationship between income and tax burden.” This must apply even more strongly when the requirement of equality is absent. Thus the principle does not automatically point to progressive taxation instead of proportionate taxation. Under either system, “the rich” pay more in tax than “the poor,” so both could be defended as consistent with ability to pay. Perhaps this is why this approach has appealed to both ends of the political spectrum. However, there is a danger that the unmoderated ability to pay approach can be used somewhat arbitrarily to justify any level of taxation on a group defined as able to bear it, which will usually be “the rich.”

Even leaving aside this concern, deciding on an appropriate measure of ability is problematic. One contender is income, but two individuals with the same level of income may have very different situations affecting their ability to pay tax. One may have a large mortgage and a large family, while the other may be child- and mortgage-free. Two individuals with equal capability to do the same job and earn the same salary seem to have similar abilities to pay taxes, but if one chooses to prioritise leisure over work and earn less, while the other works harder and earns more, a measure of ability that is based on income will treat them quite differently. Broader measures of ability, such as net worth or welfare, would require complicated and potentially intrusive assessments, and would risk discouraging individuals from undertaking activities that increased their ability to pay taxes.

Even if an appropriate measure of ability can be agreed on, there is still a stumbling block in the lack of any real justification for taking from someone simply because they can afford it. There is also a further problem with ability to pay: it “views equity as a one-sided problem in taking only; that is, it argues for a just distribution of the tax burden imposed by raising a given amount of revenue, regardless of benefits received.” The figures discussed earlier demonstrate that much of the benefit of tax-funded government spending accrues to those who bear the least tax burden. Of course, to the extent that government spends money to achieve social objectives it should be targeted to those in need (see section 3), who by definition will pay the least tax. The point here is not to query assistance to those in need, but rather to say that it is difficult to calculate the sacrifice that taxpayers are making without also considering whether tax-funded benefits increase or decrease that sacrifice in some way. In other words, the pattern of government spending, as well as the pattern of income distribution, is relevant if the ability to pay principle is to be used to allocate the tax burden. Without this fuller picture, it is possible to over-estimate the sacrifice made by lower income earners and under-estimate that of higher income earners.

**Rawls’ theory of distributive justice**

One of the best-known theories of distributive justice is that of John Rawls. He relies on the notion of people “behind a ‘veil of ignorance,’” trying to come up with rules to govern a society without any knowledge of the position they will occupy in that society, or their particular interests, when the rules have been finalised and the veil is lifted. This situation is dubbed the “original position,” and as the rules chosen in it are those “which people would choose without taking into account special interests, they are objectively just.” Rawls considers that those in the original position, concerned that they might turn out to reside in the lower strata of society when the veil is lifted, will agree that “social and economic inequalities” are to be qualified by “the difference principle,” that is, the requirement that inequalities benefit the least advantaged most. The difference principle is subject to the requirement that “Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all.”

Note that the difference principle permits inequality of outcomes, so long as it benefits the “least-advantaged,” the “equal basic liberties” are not traded off and “fair equality of opportunity” is maintained. “Fair equality of opportunity” is introduced “to correct the defects of formal equality
It requires: not merely that public offices and social positions be open in the formal sense, but that all should have a fair chance to attain them. In all parts of society there are to be roughly the same prospects of culture and achievement for those similarly endowed. Fair equality of opportunity here means liberal equality. To accomplish its aims, certain requirements must be imposed on the basic structure beyond those of the system of natural liberty. A free market system must be set within a framework of political and legal institutions that adjust the long-run trend of economic forces so as to prevent excessive concentrations of property and wealth, especially those likely to lead to political domination.

Rawls also makes it clear that the difference principle incorporates an idea that those who are better off in terms of their “native endowments” cannot claim that they morally deserve this, and so it “represents an agreement to regard the distribution of native endowments as a common asset and to share in the benefits of this distribution whatever it turns out to be.”

Rawls’ theory has prompted much debate. It is not necessary to canvass the debate in its entirety, but we should note a significant critique. The requirement to prefer the least advantaged is clearly an important limitation. Thus Nozick claims that a distributive theory such as this necessitates: continuous interference with people’s lives. Any favored pattern would be transformed into one unfavored by the principle, by people choosing to act in various ways. To maintain a pattern one must either continually interfere to stop people from transferring resources as they wish to, or continually (or periodically) interfere to take from some persons resources that others for some reason chose to transfer to them.

In other words, while inequalities may be able to be arranged in a way that benefits the least advantaged at the moment the veil of ignorance is lifted, the passage of time and normal human interactions will inevitably upset this distribution unless otherwise free transactions are forcibly prevented or unless they are allowed to occur but subsequent corrective action is taken. The interference with individual freedom is substantial. As Nozick makes clear, the criticism applies to all theories of distributive or “patterned” justice. There are also important and problematic questions about who decides what the appropriate pattern of resource distribution is, and what amounts to “excessive concentrations of property and wealth,” sufficient to justify departures from the otherwise free allocation of resources.

In addition, even if it is accepted that people do not morally deserve their natural abilities, it is not necessarily moral to deprive them of what they may produce or earn by using those abilities in order to benefit others. For one thing, abilities are only one component in people’s capacity to produce or earn. Their own decisions—about whether to work, save, invest, study, devote time to recreation, have a family, and so on—also play a significant role. In fact, it is difficult to see how to separate out the proportion of earnings that is due to natural abilities (and therefore, it is argued, undeserved) and the proportion that is due to personal decisions and effort (and therefore deserved). Some might argue that even people's decisions are a product of inherited (and therefore undeserved) abilities and genetic endowments, or lack of them. This adds to the risk that this line of thinking poses, of proving too much and undermining the idea of people deserving anything at all. This seems incompatible with our moral intuitions. It is also incompatible with the idea of "self ownership." This is the recognition that people own themselves and, therefore, their labour and its fruits. The alternative to self-ownership is to say that the group owns the individual or at least some portion of what he or she produces. Legal academic Richard Epstein points out the problems with this: if “A does not own A’s labor, … A is no longer entitled to sell A’s labor, and therefore has less of an incentive to improve it. Likewise, things that are made by his hands are no longer his either, but instead belong (if they are made at all) to that group which owns the labor in question. Finding those individuals or groups who are co-owners in A’s labor is no easy task.” Epstein goes on to say that "A rule of self-ownership, far better than any of its alternatives, allows us to move on with the business of life. [It] selects the single person to be the owner of each person’s natural talent, and picks that person who in the vast majority of cases tends to value those assets the most ... the rule offers the shortest path from initial entitlement to productive human activity." Perhaps the uncomfortable truth is that a certain
degree of moral arbitrariness is a fact of life. After all, perhaps a Lotto winner does not morally deserve their first division prize, but rather than say that their winnings must therefore be used to benefit the least advantaged, society simply regards them as lucky, and leaves it at that.

In the end, some advocates of this standard of distributive justice have fallen back on the argument that “acceptance of the ethical premise of equal worth and a setting in which individuals will agree to choose impartially” can be justified on the basis of “what might be called good manners in a democratic society.” Concepts such as “good manners” are rather vague though, and there is a risk that they may cloak subjective value judgements about what the rules of justice should be. After all, accepting that individuals have equal worth and that decisions should be made impartially is just as important to justice in process, with its emphasis on a “formal equality” that holds that everyone is entitled to equal treatment by virtue of their equal worth and status.

**Equality**

As has already been discussed, equality looms large in the discussion of tax justice in New Zealand. Inequality in incomes or in wealth has become a standard measure of injustice, and most people hold some sort of notion that unequal outcomes indicate that something is amiss. This intuition, which is shared by others in other countries, is no doubt reinforced by egalitarian strands running through New Zealand’s culture and by tax policies, such as progressive taxation, which seek to redistribute income and wealth. As a result, official reports often measure the distribution of income and wealth, and particularly inequalities in that distribution.

In a report published in 2007, Statistics New Zealand analysed the distribution of individuals’ net worth. They found that New Zealand has a “skewed net worth distribution … not untypical of a developed economy.” In fact:

The top 10 percent of wealthy individuals own over half (51.8 percent) of total net worth. Some 16.4 percent of total net worth is shown as owned by the top 1 percent of wealthy individuals … the bottom half of the population collectively owns a mere 5.2 percent of total net worth, although this takes into account the considerable negative net worth of 6.5 percent of the population.

Of those with “negative net worth,” “nearly half of all cases are between ages 15 and 24, and who might therefore be expected to be predominantly students. The number reduces rapidly over the working ages …”

<table>
<thead>
<tr>
<th>Percent of total net worth</th>
<th>Cumulative (%)</th>
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<tbody>
<tr>
<td>Top 1%</td>
<td>16.4</td>
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<tr>
<td>Next 4%</td>
<td>21.3</td>
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<tr>
<td>Next 5%</td>
<td>14.1</td>
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<tr>
<td>Next 40%</td>
<td>43.0</td>
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<tr>
<td>Bottom 50%</td>
<td>5.2</td>
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The report also examined net worth across age groups to provide “the likely lifetime net worth.

**Figure 2.1. Median and mean net worth value by five-year age group**

accumulation trajectory.” It found that “Individual net worth is expected to be at a very low level among youth. Net worth accumulation can be expected to accelerate through the working ages, from ages 25-29 to peak between ages 55 and 69; ... The level of median net worth stays relatively unchanged at post-retirement ages.”

The report also found “significant disparities ... between major ethnic groups, which in part are driven by the differences in their age structures,” and between family types.

In its report, “Wealth Disparities in New Zealand,” Statistics New Zealand advise that:

Wealth disparity persists in New Zealand, as in other societies. Disparity in wealth holdings is of significant interest in respect of its implications for health outcomes, economic and social wellbeing, opportunities for social participation, ability to withstand life shocks, and so on. Our first step is to get the best picture we can of the distribution of wealth. To the extent that this shows significant disparities, there are further questions as to what are the causes and the consequences of these disparities, and hence what policy interventions may be required.


But what exactly does “equality” mean? How can it be measured? What can be used to make meaningful comparisons between individuals, families, sexes, racial and ethnic groups? Possible measures include welfare, income, wealth and sacrifice, but are they appropriate? And if disparities in wealth or other measurements exist, are policy interventions necessarily required, as implied above? Is the focus on equality even appropriate?

**What does “equality” mean?**

Equality has been a concern of political theory and philosophy for centuries. It is beyond dispute that “formal” equality, or “equality before the law,” is central to democracy. This is the recognition that everyone has the right to equal treatment by the law, by virtue of their equal status as persons. Some, however, promote a different conception of equality, seeking to treat people unequally in a formal sense in order to make their outcomes more equal. “Equality of opportunity” also features prominently in the literature, but it can have more than one meaning. It can mean “allowing people to do the best they can with their endowments,” or it can mean “that inequalities in endowments ought to be addressed in an attempt to ensure that each person has an equal chance of ending up in any given situation.” This latter conception “is closer to equality of outcome.”

Emphasising income and wealth inequality and redistribution is consistent with a concern to make outcomes more equal. It is, however, rather difficult to decide what outcomes count as relevant for this purpose, or how to measure them. The most useful measure would be something like total welfare, because it is comprehensive. Total welfare would encompass everything from our financial position to our social capital, our family situation and how much income we are prepared to trade off for leisure. However, there is no way to quantify anything like total welfare. As a result, those who are concerned with more equal outcomes generally settle for the more limited goal of “equalising along certain very restricted dimensions, such as equal money incomes in a given year” or adjusting “levels of taxation and cash transfer so that prevailing levels of consumption and wealth are more just than they otherwise would be.”

**Inequality in incomes or wealth**

Income inequality or inequality in wealth is therefore best understood as a substitute for a measure of inequality in overall welfare. Of course, something has to be selected as the tax base, so for practical reasons the best measure may be a substitute one. Nevertheless, it is important to be aware that substitute measures are an imperfect means of pursuing their goal, and reliance on substitutes may actually result in moving further away from the ultimate goal.

For example, the inquiry into inequality relies on a snapshot of the distribution of income or wealth at a particular moment. But this picture changes over time. As the data from Statistics New Zealand indicate, people’s wealth tends to vary throughout their life depending on whether they study, gain...
experience at work, move into higher-paying jobs (and out of them when they retire), and have families. Ensuring equality by, for example, “[r]edistributing money income from a building worker to a university student may reduce inequality of money incomes in a given year, but it will almost surely increase inequality of lifetime earnings.”38 Put simply, almost everyone can expect to be better off at some stages of life and worse off at others, in financial terms. Of course, some may face genuine hardship for extended periods of time. The implications of such need are discussed in section 3. For now, it is enough to note that concern for need is not necessarily the same thing as concern for equality.

Another difficulty concerns the statistical measures of inequality. One measure that is employed by the Ministry of Social Development and Statistics New Zealand is the Gini coefficient. In “The Social Report 2008,” the Ministry tells us that:39

Gini coefficients measure income inequality, with a score of 100 indicating perfect inequality and a score of 0 indicating perfect equality. The most recent OECD comparison (from 2004) gives New Zealand a score of 34, indicating higher inequality than the OECD median of 30 and a ranking of 23rd equal out of 30 countries. ... The 2007 Gini score for New Zealand was still 34.

However, the Gini coefficient only measures “the degree of inequality, not the pervasiveness of poverty,” and as a result “would measure a reduction in the incomes of the highest earners that provides nothing to anyone else as a desirable change.”40 A further problem with selecting a limited measure such as income or wealth is that “many differences in income are chosen by people because they prefer non-monetary rewards to higher income.”41 Someone who leaves a high-paying, long hours job and chooses to work a minimal number of hours per week in a low-responsibility job so that they can spend their week-days watching television will have a lower income than their former colleague who gives a lower priority to recreation and a higher priority to working long hours and so remains in the job. Treating them as unequal solely by reference to their incomes does not take into account the very different choices that they have freely made. Obviously this criticism will not apply across the board, as not everyone has the same choices open to them, and so differences in income might be due to bad luck rather than a free decision to watch Oprah during the day. However, the focus on inequality of incomes or wealth is unable to take these differences into account, because it measures all people in the same way and treats them uniformly, regardless of whether their free choices created their different outcomes or whether they are actually in need due to events outside of their control.

As legal theorist Nigel Simmonds says, in such a situation:42

An egalitarian who focuses solely on money and sets about taxing me and benefiting you, is making us unequal. ... Notice also that this crude monetary egalitarianism discriminates unfairly between different conceptions of a good life. The chap who likes leisure time and little money does very nicely thank you: the chap who likes money and fast cars has to work much harder than would otherwise be necessary.

**Equal sacrifice**

There is a long history to the idea that the tax burden should be distributed so that the sacrifice it involves is equal. This requires all taxpayers to sustain “the same loss of welfare”43 or suffer “equal hurt.”44 As has been discussed, the idea is related to that of ability to pay, in that the sacrifice that a taxpayer can sustain provides a measure of ability.45

In this theory, sacrifice is not measured by the number of dollars that must be given up. It is based on the theory that income has a “declining marginal utility.” This theory holds that “It seems likely that a dollar has less ‘value’ for a person with a million dollars of income than for a person with only a thousand dollars of income. To take the same number of dollars from each is not to require the same amount of sacrifice from them.”46

There are two main ways of interpreting “equal sacrifice.” Firstly, “that the quantity of sacrifice, that is, the loss of units of utility, demanded of each individual be equal.” This would mean that rich and poor alike make the same amount of sacrifice. Secondly, “it can mean that each should be required to give up an equal percentage of his total utility derived from money.” This would mean that the actual amount of sacrifice made would vary with means, and so this interpretation is dubbed “proportionate sacrifice.”47

Proportionate sacrifice finds favour with some because “The claim that those who are better off
can afford a greater real sacrifice embraces taxation as a legitimate means of redistribution away from market outcomes, to the benefit of the worst-off at the expense of the better-off.\textsuperscript{48}

There is a strong element of common-sense to the idea of declining marginal utility. But whether this provides a sufficiently firm foundation for a theory of tax justice is a different question. Slemrod describes the idea that “paying a dollar is a lesser sacrifice for a well-to-do person than for a poor person” as “plausible, but unprovable.”\textsuperscript{49} And “it is one thing to assume that the utility of money declines but quite another to assume the rate at which it declines,”\textsuperscript{50} and if the intention is to generate a progressive income tax from the idea of declining marginal utility, it is necessary to show that the progression in the rate scale corresponds in some way to the declining marginal utility curve.

This, it turns out, is a rather difficult thing to show with the required degree of precision, as shown by the incisive analysis of Walter Blum and Harry Kalven of the University of Chicago’s Law School.\textsuperscript{51} To begin with, they exclude from consideration those who are below a “minimum subsistence level,” consistently with their view that the considerations of tax justice are different for those who are below that level than they are for those above it.

Blum and Kalven then go on to consider some of the main arguments purporting to show that money is valued less as income increases. One of these arguments is that the things that additional income are used to buy are less important than more basic goods, implying that taxing that additional income more heavily will only deprive the taxpayer of the less important satisfaction of, say, owning a spa pool, rather than preventing them from being able to afford a roof over their head. As Blum and Kalven say, “this view oversimplifies the facts. Although it is agreed that at any income level a man disposes of his income so as to maximize his satisfactions, the process of doing so is not crudely cumulative.”\textsuperscript{52}

Another common argument for money’s declining marginal utility assumes that, as income increases and is valued less highly, people will not be so willing to spend their time working to earn that money, and will prefer to spend their time in leisure instead. But Blum and Kalven point out that those “at all levels of the income scale seem to work roughly the same amount.”\textsuperscript{53} Indeed, many high-paying jobs involve longer hours than low-paying jobs. While there may be several reasons why people would be willing to work these long hours, it seems reasonable to assume that one reason is likely to be that they value the additional income that comes with the job. And “[i]f willingness to work more is being measured not by time alone but by the intensity of effort during a given time, there is simply no basis for making comparisons.”\textsuperscript{54} Of course, as income increases some people will actually value income less and leisure more, and will choose to substitute leisure for work. Others would substitute leisure for work if they could, but are bound to work a set number of hours regardless of income. The actual overall picture will depend on the interaction of what economists call the “income effect” and the “substitution effect.” The income effect occurs because “a loss of income may cause an individual to work harder to maintain their lifestyle,” while the substitution effect “occurs when higher taxes reduce the opportunity cost of leisure, leading to greater consumption of leisure,” meaning that leisure is substituted for work.\textsuperscript{55} This complicates the analysis of whether money is valued less as income increases. Nevertheless, the issue Blum and Kalven are addressing is whether money can be said to have a declining marginal utility for all taxpayers, and whether it declines at a consistent rate for them all. This, they conclude, cannot be shown.

For the idea of declining marginal utility to justify progressive tax rates and redistribution, the same declining curve must apply to all taxpayers. In other words, they must all value increasing income at exactly the same decreasing rate, and there is no way to prove this—all that we can appeal to is “sheer intuition.”\textsuperscript{56} Intuition actually suggests the opposite. The argument “assumes that individuals can be divided into income groups that are homogenous within themselves, derive the same satisfaction from income and consume the same bundle of goods and services. It assumes that this satisfaction is measurable, comparable and known to the tax authority.”\textsuperscript{57} Clearly, this assumption is problematic.

Musgrave, while noting the force of the objections to equal sacrifice, was hesitant about rejecting the principle. Pragmatically, he considered that the “interpersonal utility comparisons” that the principle requires “are made continuously, and in this sense have operational meaning.” However, he cautioned that it still remained to be shown “whether
a workable and reasonably meaningful measure of utility can be developed in time and whether thereby the subjective concept of ability to pay can be given an operational meaning. At this stage, we do not possess a universally accepted measure of utility by which to apply one or the other sacrifice formula."58

No consensus on utility has emerged since Musgrave wrote those words nearly 50 years ago. Perhaps this is because, as Blum and Kalven say:59

The paradox is an ancient one. Men have long speculated over whether the man in the palace is happier than the man in the cottage. On the one hand there is no doubt that money is a good and that it is desirable. On the other hand it seems that whenever we try to state more precisely its relationship to happiness the result approaches an absurdity. The error lies in trying to translate money, which can be measured in definite units, into corresponding units of satisfaction or well-being. In the end satisfaction in the sense of happiness defies quantification. Utility is a meaningful concept; units of utility are not. It is in the face of this difficulty that, even waiving all other objections, the whole elaborate analysis of progression in terms of sacrifice and utility doctrine finally collapses.

Vertical and horizontal equity

Vertical and horizontal equity are regarded as traditional principles of tax justice. Horizontal equity is the idea “that people in equal positions should be treated equally,” while vertical equity requires that “taxation among unequals should differ” in a way that corresponds with their degree of inequality.60

Horizontal equity’s focus on equal treatment means that it primarily concerns processes, so it is discussed later in this section. Vertical equity, by contrast, “is part of the larger problem of distributive justice”61 and concerns outcomes.

The difficult question with vertical equity is in deciding when people should be regarded as “unequal.” What features should be used, and how should they be measured? Income is the usual candidate; the progressive rates of the personal income tax are built on the premise that income is an appropriate way of determining whether people are unequally situated and, if so, to what degree. However, income is not an entirely accurate measure of position—someone who is single and childless and on a low income may, in a practical sense, be equal with someone on a high income with a family to feed, but income taxation treats them quite differently. Additionally, sheer practicalities mean the principle cannot be fully applied. As a result, income tax brackets treat varying levels of income equally—for example, up until 1 October 2008 incomes of $38,001 were taxed at the same top marginal rate as incomes of $60,00062—and incomes either side of the brackets, which vary by a much smaller amount than do incomes within the brackets, are treated differently. Again, practicalities mean a certain degree of arbitrariness is inescapable, but it does suggest the relationship between income and equality is imperfect.

A social cohesion argument is often made in support of vertical equity: “High levels of inequality are associated with lower levels of social cohesion and personal wellbeing, even when less well-off people have adequate incomes to meet their basic needs.”63 Sometimes it is also argued that inequality of wealth, and its concentration in the hands of a few, can corrupt the political process and ensure that political power is the prerogative of the wealthy.64 While there may be some truth to the concern for social cohesion in extreme cases of poverty throughout a nation, the gap between the rich and the poor in New Zealand does not currently seem so great as to create a serious risk of social instability and unfair treatment. In fact, the latest indicators suggest that the gap is reducing.65 Even if there were a threat to social cohesion, the key question would be whether reducing income inequality, whether through government transfers or otherwise, would be the best way to meet that problem. Strategies which are conducive to economic growth, which enable overall living standards to rise, may be a better way to ensure that those facing hardship are able to meet their needs and enjoy a full role in society. In any case, attempts to promote social cohesion by levelling people through high taxation can be counter-productive, as they are likely to cause feelings of resentment. In addition, if people feel like they have already contributed to those in need through their taxes they are less likely to feel personally responsible to help those in need around them. Social cohesion is more likely to be fostered by the voluntary assumption of responsibility and mutual interdependence than by imposed redistributive transfer programmes.

On the subject of political corruption and inequality, it seems that economic clout does not translate directly into political power. After all, the
ACT Party outspent the Maori Party, New Zealand First and the Green Party at the 2005 general election for a smaller return of Parliamentary seats, and while the two biggest parties, National and Labour, outspent them all, there are many reasons for their greater electoral success other than advertising expenditure, such as their size and history and the policies they offered the electorate. Laws against political corruption are the most effective and important safeguards here.

**Conclusion: equality**

What often motivates those who are concerned about inequality is that it can be associated with some people being in great need, while others have plenty. Where this is the case, the true concern appears to be unmet need rather than inequality itself. But it is important to ask whether it actually matters if some have more than others, so long as no-one is condemned to a lifetime of poverty. As Green says, “So long as the standard of life of the poorest person is acceptable, why should the state be concerned at all with income relativities?”

However, some may actually be concerned with inequality for its sake. If so, this is a misplaced concern. The only way to fully meet the concern would be to equalise people’s resources by, for example, imposing a maximum threshold for income and redistributing anything above that threshold, until everyone had the same level of wealth. But this would involve drastic limitations on freedom and it would create disincentives to work and productive activity. Of course, things might not be taken to that extreme, but it is hard to see how reducing inequality for the sake of it, uncoupled from any real concern about need, would be beneficial in the long run.

**The benefit principle**

A traditional way to assess justice in taxation is to use the benefit principle. This is the idea that, because everyone “derives some benefits from the operation of government,” the burden of taxation can be justified by reference to the tax-funded benefits that people receive.

This begs an important question: should government functions and services really be regarded as benefits that people should pay for through their taxes? In other words, should taxes be treated as the price of government services, which users of those services (taxpayers) must pay? This “user pays” philosophy might be appropriate for some things that government provides, such as vehicle registration, where the cost of the activity can reasonably be allocated to the person who engages in it, and where he or she has a choice about whether to do it, and to what degree. But it would be dangerous to start regarding “public goods” like law and order as benefits that taxpayers should pay a price for, as there will obviously be those who are unable to afford the price of those things that are vital to a functioning society.

Despite this, some have argued that government services such as the police and the fire service function as a type of insurance, and so as wealth increases, the potential benefits of the insurance increase and so, therefore, should the price paid for the insurance. However, it is doubtful that potential benefits increase in proportion to wealth, if only because the services necessary to protect people’s physical integrity and a small amount of property, which must be maintained at a minimum, will be sufficient to protect larger amounts of property as well so that there is no additional cost to justify a higher burden on wealthier property-owners. This has led to attempts to replace measurable direct benefits with a proxy measure, such as income or wealth, but a person’s income or wealth are not necessarily a good representation of the benefits they have received from government.

In addition, “the benefit principle gives us no guidance on what the tax rate or rates should be, because it gives us no guidance as to the appropriate level of government expenditure.” And if benefits should be measured not by what the government decides to spend on them, but by reference to what taxpayers “would be willing to pay to obtain them,” then they cannot actually be measured.

Despite the fact that the benefit principle has been used in an attempt to justify higher taxes on the well-off, the figures presented earlier actually reveal that those who are less well-off receive greater benefits from total government spending. Government spending on the “insurance” services said to disproportionately benefit the well-off, such as “maintaining law and order, or providing defence against external threats,” is only a small proportion of total expenditure, which includes health, education...
and welfare (see Figure 2.2). These “insurance” services actually “protect the weak from the strong—without the forces of law, the people with least would suffer the most.” All of this means that the benefit principle is not a good theory of justice in taxation.

**JUSTICE IN PROCESS**

Justice in process asserts that whether a situation is just simply depends on whether just processes have been followed. Justice in process is, therefore, “distributionally neutral,” meaning that it does not ask whether the outcomes that result from the processes conform to some desired pattern. It requires only “equality before the law,” not equality of outcomes.

Focusing on process, rather than outcomes, is the usual approach to transactions and exchanges between private parties. For example, when a purchaser agrees to buy a house from a vendor, the parties will be held to the terms of their bargain unless there is some defect in the process, like fraud or misrepresentation. The mere fact that one party subsequently decides they do not like the outcome, perhaps because they realise they could have obtained a better deal elsewhere or because house prices slumped the day after they signed the sale and purchase agreement, does not mean that it is unfair to enforce the contract. It is even accepted that it is just to uphold legitimate agreements where this will lead to one party facing a serious adverse outcome like bankruptcy. Proponents of a justice in process approach to taxation would say that the same logic should apply to transactions between private citizens and the state. In other words, the justice of taxation does not depend on whether the state uses it to achieve certain outcomes, but on whether the tax system treats people properly and respects legitimate ownership.

One of the best-known and most influential approaches to justice in process is that of philosopher Robert Nozick. Other approaches which prioritise process over outcomes are utilitarianism and horizontal equity.

**Nozick’s theory of justice**

Nozick summarises his theory of entitlement as follows: "the holdings of a person are just if he is entitled to them by the principles of justice in acquisition and transfer, or by the principle of rectification of injustice ... If each person’s holdings are just, then the total set (distribution) of holdings is just." He goes on to contrast this with distributive justice theories:

Almost every suggested principle of distributive justice is patterned: to each according to his moral merit, or needs, or marginal product, or how hard he tries, or the weighted sum of the foregoing, and so on. The principle of entitlement we have sketched is not patterned. There is no one natural dimension or weighted sum or combination of a small number of natural dimensions that yields
the distributions generated in accordance with the principle of entitlement.

In other words, as long as assets were justly obtained in the first place, and have been justly transferred ever since, their current location is just and so is their overall spread, regardless of how unequal it is. The only justification for correcting the spread of assets is the possibility that they have not been acquired or transferred justly, in which case the “principle of rectification” can allow the injustice to be remedied.

One of the strengths of Nozick’s theory is that it is factual or “historical,” as he puts it. “[W]hether a distribution is just depends upon how it [actually] came about.”77 By contrast, social contract theories such as Rawls’ rely on a fictional, pre-societal agreement between hypothetical persons. This divorce from reality results in contractarian theories being criticised on the basis that they do not tell us much that is useful about the way society actually is and, therefore, how it should be governed.

Nozick bases himself on the idea that “raw” assets can come to be acquired by someone who mixes their labour with them, thus becoming their owner. This proposition, originally formulated by John Locke, is what undergirds “the principle of justice in acquisition,” which in turn gives content to “the principle of justice in transfer.”

However, Professors Liam Murphy and Thomas Nagel, of New York University’s Department of Philosophy, reject the idea that anyone has an unqualified entitlement to what their labour produces. Their argument is that “It is illegitimate to appeal to a baseline of property rights in, say, ‘pretax income,’ for the purpose of evaluating tax policies, when all such figures are the product of a system of which taxes are an inextricable part.”78 The conclusion they draw from this is that people do not, in fact, own their entire gross income. Rather, they own only that proportion of it that remains after taxes have been subtracted, for without the government services that those taxes represent, nothing like that income (gross or net) could have been earned.

This is a serious challenge to the Lockean conception that underlies Nozick’s theory. However, it ascribes too much to government. What people earn, and what they do with their earnings to generate further wealth, depends a great deal on the decisions and choices they and others around them make, and, to a degree, on simple luck. Quantifying the contribution that these factors make to gross income, so that a remainder could be identified as the product of government services, would be impossible. Even if you think Murphy and Nagel’s idea has merit, we need “workable bases on which a tolerable system of taxation can rest.”79

The only alternative is to hold that the government has a claim to some undivided share of an individual’s income, or even all of it, on the basis that all of its expenditure is necessary to enable people to function well enough to be able to earn that income. This implication, like the others drawn from Murphy and Nagel’s framework, and like the framework itself, conflicts with the idea of “self-ownership,” described earlier in this discussion paper. We recognise that our endeavours and our decisions bring the fruits of our labours into being, and while certain “background” factors such as the legal framework maintained by the government and simple luck may also have played a part, those background factors are available to all and, therefore, do not affect the ownership of property. Murphy and Nagel might dismiss this view as the product of a mere legal convention of private property,80 but as has been discussed, the alternative is to say that the group owns the individual or at least some portion of what he or she produces. Not only is this likely to discourage valuable enterprise, but the idea of some people owning others or being able to compulsorily acquire the fruits of their labour is deeply problematic.

In addition, Murphy and Nagel seem to rely on a conception of government as something that sprang up and created an environment that enabled us all to prosper. But government only exists because people first created it, and it only functions because people first paid for it. While they conclude that government owns some share of the fruits of our labour, it seems more accurate to say that we, through the fruits of our labour, created government and endowed it so that it can perform functions that enabled us to prosper. If government owns some share of its citizens’ pre-tax incomes, we in turn own government, and hence those shares.

Utilitarianism

The theory of utilitarianism says that morality or justice depend on whether some desired end (in
classical forms of the doctrine it is pleasure, and in more modern forms it is welfare) is maximised across society. When considering whether a course of action is just, a decision-maker should weigh up the gains that some people get (of pleasure, welfare, or whatever the desired end is) against the losses that others sustain. If there is a net gain, utilitarianism tells us that the action is just. If the decision-maker must choose between two courses of action which both result in a net gain, they should choose the course which results in the greatest net gain. Utilitarianism "convert[s] all goals and preferences into a single currency."81 Utilitarianism is only concerned to see that welfare is maximised. It is not concerned with its distribution (unless a certain pattern of distribution will maximise welfare).82

However, there are a number of difficulties with utilitarianism, a few of which are summarised here. To begin with, attempting to measure pleasure or welfare with any precision on an individual basis, "is an inherently uncertain and speculative enterprise," and the problem is exacerbated by trying to engage in "interpersonal comparisons of utility," that is, trying to add one person’s welfare or happiness to the welfare or happiness of others and then weigh the aggregate against the welfare of others still.83 Utilitarianism has also been criticised on the basis that this adding of interests means that "utilitarianism treats people as lacking any distinctness, but as receptacles in which welfare is to be maximised,"84 a view that is inconsistent with the recognition that each individual has intrinsic worth by virtue of their humanity. Finally, "a total utility made up of small advantages for each of a sufficiently large number of individuals can outweigh a large disutility, consisting of a major sacrifice for a small number of individuals,"85 and equally a large gain for a few individuals could outweigh losses for a larger number.

**Horizontal equity**

Horizontal equity, as has been said, requires “that people in equal positions should be treated equally.”86 There is a great deal of intuitive appeal to this idea, but as with vertical equity, it is no easy task to decide when people are equal in a way that justifies equal tax treatment. If income or wealth are treated as a relevant measure of equality, then one possible implication for taxation is that "People with the same incomes (or other relevant economic measure) should pay the same amount of tax."87 There are familiar problems in selecting the appropriate measure to use to define whether people are equal. Economist Harvey Rosen considers whether wealth, income or expenditure can be used as the measure of “equal positions.” He concludes that “all of these measures represent the outcomes of people’s decisions and are not really suitable measures of equal position.” He gives the following example:88

Consider two individuals, both of whom earn $10 per hour. Mr A chooses to work 1,500 hours each year, while Ms B works 2,200 hours each year. A’s income is $15,000 and B’s is $22,000 so that in terms of income, A and B are not in ‘equal positions.’ In an important sense, however, A and B are the same, because their earning capacities are identical—B just happens to work harder. Thus, because work effort is at least to some extent under people’s control, two individuals with different incomes may actually be in equal positions. Similar criticism would apply to expenditure or wealth as a criterion for measuring equal positions.

Rosen concludes that horizontal equity is vague, but highly appealing and therefore will continue to influence tax policy.89 Of course, it is important to treat people in the same positions in the same way, but perhaps the difficulties in defining equal positions by reference to wealth, income or expenditure mean that the best approach is to equate horizontal equity with “formal” equality, or “equality before the law.” This would mean that all taxpayers should be treated in the same way, rather than trying to divide taxpayers into groups by reference to something like the amount of income they earn or their wealth.
ENDNOTES

15. J. Rawls, Justice as Fairness: a restatement, 42.
17. J. Rawls, Justice as Fairness: a restatement, 44.
19. R. Nozick, Anarchy, State, and Utopia, 163.
20. R. Epstein, Simple Rules for a Complex World, (Cambridge, Massachusetts: Harvard University Press, 1995), 54-59. Epstein draws on John Locke: “every man has a property in his own person. This nobody has any right to but himself. The labour of his body, and the work of his hands, we may say, are properly his.”
34. C. Buchanan and P. Hartley, Equity as a Social Goal, 33.
35. C. Buchanan and P. Hartley, Equity as a Social Goal, 193.
36. C. Buchanan and P. Hartley, Equity as a Social Goal, 5.
38. C. Buchanan and P. Hartley, Equity as a Social Goal, 117.
40. C. Buchanan and P. Hartley, Equity as a Social Goal, 128-129.
41. C. Buchanan and P. Hartley, Equity as a Social Goal, 139.
47. W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 41.
50. W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 41.
59 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 63, internal citations omitted.
62 After 1 October 2008 the personal income tax scale changed. See Table 6.1.
64 Rawls writes of the need to “adjust the long-run trend of economic forces so as to prevent excessive concentrations of property and wealth, especially those likely to lead to political domination.” J. Rawls, Justice as Fairness: a restatement, 22.
68 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 35.
69 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 36-37.
70 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 37-38.
73 C. Buchanan and P. Hartley, Equity as a Social Goal, 177.
75 R. Nozick, Anarchy, State, and Utopia, 153.
76 R. Nozick, Anarchy, State, and Utopia, 156-157.
77 R. Nozick, Anarchy, State, and Utopia, 153.
81 N. Simmonds, Central Issues in Jurisprudence, 9.
82 N. Simmonds, Central Issues in Jurisprudence, 29-30.
83 N. Simmonds, Central Issues in Jurisprudence, 25.
84 N. Simmonds, Central Issues in Jurisprudence, 63.
89 H.S. Rosen, Public Finance, 348.
There are several themes that flow through the discussion of justice in outcomes that undermine confidence in an outcomes-focus as an overarching conception of justice. There are both philosophical and practical reasons for this lack of confidence.

The sort of oversight and corrective action that would be necessary to achieve and maintain some favoured distribution of outcomes should be a cause for great concern in a free and democratic society, as it would require substantial, on-going interference with people's decisions about how to work and live. Nozick has already been cited on this point. Others share his concern, and Green has this to say:

In the sort of society favoured by egalitarians a person might be able to prosper by hard work, investment or saving, but only up to that point approved by the government of the day. That is, people would be pawns in a game played by government. They would not be actors with their own values, thoughts and aspirations entitled to follow their own inclinations so long as they do not infringe pre-ordained laws designed to give everyone similar freedom.

Green goes on to express concern that a focus on adjusting people's outcomes would result in "arbitrary political power because the government would be entitled to 'rectify' any material outcome it did not like." Perhaps in twenty-first century New Zealand it is easy to lose sight of the importance of protecting against arbitrary government, as the political and social upheaval that established the principle took place centuries ago on the other side of the world. But the principle is one that needs to be cherished if it is to last, and it is instructive to be reminded by Hayek that, "The great aim of the struggle for liberty has been equality before the law. ... Equality of the general rules of law and conduct ... is the only kind of equality conducive to liberty and the only equality which we can secure without destroying liberty." The importance of freedom has already been discussed. The proper limits to it will be covered in section 5.

In addition, there are a number of practical reasons why measuring justice by reference to outcomes is problematic. For one thing, selecting and measuring an appropriate outcome to use as a reference point is extremely difficult. The most meaningful measure is a broad one, something like total welfare, but such a measure defies definition or measurement. Using more limited measures, like income or net worth, are of limited value since using "an imperfect measure might be counterproductive." This limitation affects measures based on ability to pay (how should ability be measured?) and equality (equality of what?). For instance, if the aim is to equalise overall outcomes, a limited focus on equalising income might create greater inequalities between taxpayers in other respects. It also affects attempts to quantify the benefits that individuals receive from tax-funded public services.

The idea of the declining marginal utility of money, which underpins traditional conceptions of justice such as the equal sacrifice principle and influences much everyday thinking about tax justice, is also problematic as a basis for tax policy. Not only is it difficult on practical grounds—that is, it is difficult to show that everyone values money at a consistently declining rate—it does not prove by itself that it is just to take from someone income or wealth that they have legitimately acquired simply because they do not value it as much as someone else would.

Justice in process is consistent with the principles that Western democracies have been built on. It gives a high priority to liberty, and it gives appropriate
Is it Just Tax? The shaping of our society

recognition to ownership of the fruits of labour. It also avoids the practical pitfalls associated with trying to select and quantify an outcome on which a theory of justice can be based. It is, therefore, to be preferred to justice in outcomes as a measure of justice or fairness in taxation. While "[j]ustice does require that those conditions of people's lives that are determined by government be provided equally for all ... equality of those conditions must lead to inequality of results."5

However, it is important to note that while justice depends on processes, it is not merely procedural. In other words, it is important not to lose sight of the requirement that the processes themselves must be just. This means that obtaining something by fraud or theft will not be just, and subsequent transfers of those assets will be tainted by the injustice of the way they were obtained. Equally, the fact that something justly owned is transferred in accordance with legal procedures will not make subsequent holdings of those assets just if the procedures that the law prescribes are unjust. For example, laws that allow the confiscation of property from racial or ethnic minorities will not legitimise the transfer of that property simply because the law has been followed to the letter.

RECONCILING JUSTICE AND COMPASSION

Having said that justice depends on following correct processes, a potential stumbling block for this view is expressed by H L A Hart's criticism of Nozick's rights-based theory: "So long as rights are not violated it matters not for morality, short of catastrophe, how a social system actually works, how individuals fare under it, what needs it fails to meet or what misery or inequalities it produces."6 Hart goes on to say that "Nothing is more likely to bring freedom into contempt and so endanger it than failure to support those who lack, through no fault of their own, the material and social conditions and opportunities which are needed if a man's freedom is to contribute to his welfare."7

Hart is right to point out that an insistence on just process may conflict with a certain view of equality as justice and could possibly lead to issues of need being ignored. In particular, it may seem to lack compassion. When confronted by need, people rightly and instinctively feel compassion and an urge to assist. However, it is important to draw a distinction between these considerations of morality and compassion, and the concept of justice. Assisting the disadvantaged is a moral imperative, but it is not an issue of justice, strictly understood.

Our moral obligation to assist the poor to achieve an income of sufficient adequacy and dignity is an assumed responsibility. It derives fundamentally from our status as fellow citizens of the same community who together have the capacity to lift them over the line. Assumed responsibilities have nothing whatsoever to do with distributive justice, or indeed justice in any form at all. Recognition that another has a fundamental need that is beyond their power to meet naturally begets sympathy or compassion. And sympathy in turn prompts acts of generosity to assist in meeting that need.8

This means that tax policy that is designed to redistribute resources to those who are not in need is not justified on the basis of justice. When it redistributes to those who are in genuine need, it also acts inconsistently with the principles of justice, but it may be justified in doing so by compassion that recognises the interconnection of all members of society and the moral duties this entails.

These moral duties are sometimes referred to as obligations of social justice. However, it is important to be clear that the "justice" this term entails is something different from the justice this paper has been discussing. This is because social justice does not rely on correct processes creating some kind of ownership claim to resources. It does not allow someone who is in need to claim that they have an entitlement to what someone else legitimately possesses—an entitlement that could be enforced by the state. Rather, it is a recognition that those who have wealth and opportunity bear a social responsibility for those around them which is not grounded in legislation or coercion and which is independent of the government and goes beyond taxation. It says that citizens have a moral obligation to transfer their legitimately acquired wealth to each other voluntarily—and to provide assistance in other ways—when need is identified.

Social justice is similar to what has been called attributive justice. According to the natural law theorist Hugo Grotius, attributive justice is equivalent to social virtue, as it embraces "those virtues which have as their purpose to do good to others, such as generosity, compassion, and foresight in matters
These acts of virtue are above and beyond institutions of human law, and therefore are not justiciable. This means that people cannot be punished for not acting justly in these ways, since the demands of attributive justice impose demands on people that they can never fully satisfy. As Samuel Fleischacker has written, “If generosity to the poor is a prime example of attributive justice, it is an example of something that goes beyond law, not of something that law ought to accomplish.”

In practical terms, attributive justice requires that people meet the duties of compassion to people of merit. This is the obligation of everyone who lives in community. People do an injustice if they ignore their obligations to their parents or children, their benefactors or beneficiaries, or their friends and neighbours. Attributive justice therefore has at its heart a concern for the well-being of people, and may include voluntary acts of material redistribution, such as displaying charity to those in need.

This does not mean that the government, and therefore taxation, has no role to play in meeting these obligations of compassion or social justice. Where those in need are falling through the cracks, government may act outside the bounds of justice to respond to that need. Where, however, the need that grounds the obligation of compassion does not exist, government targeting of favoured recipients is neither based on justice nor on social justice. In other words, equalising and redistributing for its own sake is neither commanded nor justified by justice or social justice.

The mere existence of need and the impulse of compassion is a necessary, not a sufficient condition for government action. Before government designs tax or other policy to assist in meeting genuine needs, it should carefully consider the costs of taking action and whether the moral obligation to assist actually belongs more properly to individuals and communities. This may require a paradigm shift in thinking in a country where the first response to need is usually to ask what the government will do about it.

The first paper in this discussion series proposed that whether government is justified in acting depends in the first place on whether there is a threat to the common good of a community. This framework for government is set out in more detail in section 5. For now, it is enough to note that if a threat to the common good exists, government may be required to meet that threat if communities cannot respond adequately by themselves, and if to do so would not create too great a risk of concentration and abuse of power, loss of liberty and unintended negative consequences. But the government should not act inconsistently with the proper custom and tradition of the community as a whole, and it must respect the principle of subsidiarity. This principle requires that:

the state should not be responsible for everything. The associative communities of civil society have responsibilities that should be respected, and not interfered with or absorbed. Nevertheless, subsidiarity grants a circumscribed role for government to come to the aid of individuals and communities when they cannot protect themselves.

There are, therefore, legitimate reasons for government to be concerned with issues of social justice. Unmet need in society, leading to genuine poverty and hardship, may threaten the common good and the social fabric of the community, and the government may respond to this threat. However, before it does so, it must be clear that the communities of civil society are unable to protect the common good themselves. The action taken by government must be carefully tailored to what is necessary to meet the threat; intervention designed to impose a grand design or a favoured pattern on society breaches this principle. Crucially, government action to meet threats to the common good should be time-limited. It should only last as long as the threat, and it should be designed to enable communities to meet the threat themselves in due course. Government should not use the threat of harm to overtake and entrench itself in the communities of civil society.

So while legitimate grounds exist for the use of taxation and redistribution to meet the needs of those around us, they are narrow and tightly defined. They are based in compassion and care for others, not in justice, and community action to meet these needs should be prior to government action. Citizens, as members of a civilised society, have a responsibility to care for those around them that suffer and are in need. Countries will be strongest if they build communities that flourish. Such communities can only exist if people work to connect with those around them, through businesses, community organisations, intergenerational families and neighbourhoods. When considering the role of taxation in New Zealand, it is important to realise that transfers of wealth are not limited to what the
government does. The wellspring of a community is found in intangible aspects, the elements of relationship, social responsibility and connectedness which allow the transfer of wealth, not in a vacuum, but supported by good intention, mutual care and respect and a desire to live in compassionate and decent communities.

**IDENTIFYING THOSE IN GENUINE NEED**

Need is central to the obligations of compassion or social justice. It is therefore extremely important to be able to accurately identify who is in need, which requires an appropriate understanding and measure of poverty. As the Ministry of Social Development says, “Insufficient economic resources limit people’s capability to participate in and belong to their community and wider society and otherwise restrict their quality of life. Furthermore, long-lasting low family income in childhood is associated with negative outcomes, such as lower educational attainment and poorer health.”¹⁵

New Zealand does not have an “official poverty line.”¹⁶ The usual way that poverty is assessed is with relative measures of economic deprivation. Thus the Ministry of Social Development’s annual report finds that a household is a “low income” one if, after subtracting the cost of tax and housing and allowing for “household size and composition,” its disposable income falls below thresholds set at “50 and 60 percent of 1998 household disposable income median” (inflation adjusted).¹⁷

However, a relative measure of poverty is an inaccurate way of measuring real need. Rather, “linking the poverty line to average or median earnings ... has the result of defining a large proportion of the population as always poor, without regard to the actual standard of life enjoyed.”¹⁸ The alternative is to use an absolute measure of poverty, which is the approach taken in the United States.¹⁹ “Absolute poverty means a lack of resources sufficient to provide household members with ‘adequate’ nutrition, housing and other ‘essential’ needs.”²⁰ Economist Greg Dwyer considers that, “There are grounds for arguing that an absolute real threshold (adjusted occasionally rather than annually as median income changes) is more appropriate. Such a threshold emphasises the alleviation of hardship rather than the doubtful objective of making incomes more equal.”²¹ Dwyer also goes on to suggest that assessments of poverty should be based on spending, rather than income. This is because “spending is generally acknowledged to provide a better indication of material living standards, especially for people on low incomes. Their spending levels are typically higher than their reported income.”²² Because the poor seem to be able to spend more than their reported levels of income would suggest, “income overstates the incidence of poverty because it is not an accurate measure of the standard of living being experienced by those people who are poor. Expenditure is a more reliable measure.”²³

Calculating an absolute measure of poverty would have its own drawbacks. It would involve often contentious judgements about what is required to avoid living in poverty and to be meaningfully involved in society. Nevertheless, Buchanan and Hartley believe that:²⁴

[An] absolute poverty threshold has a number of advantages. Since the procedure is tied to explicitly named commodities and to measurable expenditure patterns, the debate about the appropriate level of the index is much more focused. The procedure also allows for the possibility that increases in average living standards can raise people out of poverty without requiring their relative incomes to increase.

An absolute assessment of poverty, whether or not it formed an official “poverty line,” is the most appropriate way to determine who is in need, precisely because it focuses on the issue of need directly. A relative measure of poverty approaches the question indirectly, and is therefore of lesser value.

**JUSTIFICATION FOR TAXATION**

Finally, it should be clarified that viewing justice as process does not mean holding that taxation is unjustified. While Nozick’s view of justice led him to conclude that “Taxation of earnings from labor is on a par with forced labor,”²⁵ taxation is justified as the means of funding government to do what it needs to do to fulfil its responsibilities in society. This, however, requires a proper understanding of what government should and should not do, and limitation of revenue collection to that amount necessary to enable it to do those things, and no more. As has been discussed, government can have a role to play in ensuring that genuine needs are met, and so taxation designed to achieve this end can be justified on this basis.
ENDNOTES


10. S. Fleischacker, A Short History of Distributive Justice, 23.


13. S. Thomas, "Governing for the Good: What does it really mean?" 26, internal citations omitted.


19. C. Buchanan and P. Hartley, Equity as a Social Goal, 146.


22. G. Dwyer, "Dissecting the Working for Families Package," 46, internal citations omitted.


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SECTION 4  
Concepts of Freedom

Although it is generally agreed that freedom or liberty is important, there is less agreement about what freedom actually is. Definitions range from an anarchic, zero-government extreme to conceptions that embrace distributive justice, with the limitations on freedom that this version of justice requires. An exhaustive review of the literature on freedom is outside the scope of this discussion paper. Instead, attention will be concentrated on the relevant, prevailing schools of thought.

In the arena of tax policy, freedom is often understood through the principle of tax neutrality. This holds that "The tax system should minimize discrimination in favour of or against any particular economic choices, which in practice means building tax systems substantially around broad income and expenditure bases and minimizing differences in tax rates that can be applied to different bases."  
Of course, it is not possible to achieve complete tax neutrality: "taxing any activity will cause people to do less of it and more of other things. For instance, the income tax creates a ‘tax wedge’ between the value of a person’s labor (what employers are willing to pay) and what the person receives (after-tax income). As a result, people work less (and choose more leisure) than they would in a world with no taxes."  
The only way to achieve perfect neutrality would be to tax leisure at the same rate as work, and regardless of the neutrality of a tax, taxpayers are still compelled to comply with it.

Tax neutrality, therefore, is not necessarily the same thing as freedom. However, it does have some similarities to the idea of freedom as absence of coercion, which holds that whether someone is free depends on whether they can be forced to do something or whether they are able to "act unobstructed by others."  
The focus on forcing people to behave in certain ways brings the issue of consent into play, an issue that has historically been of tremendous importance to taxation. However, as will be discussed, the fact of consent, and particularly Parliamentary consent to taxation, does not necessarily mean that freedom will be preserved.

It is, of course, obvious that freedom must be subject to some limits. Placing a high priority on freedom should not be allowed to descend into anarchy, which will destroy the social fabric. The important question is, how should those limits be defined? If constraints must be placed on the use of freedom, what is reasonable and permissible? Among those who have viewed freedom as absence of coercion or non-interference, Mill's "harm principle" has been influential in defining the limits of freedom. It holds that freedom may only be limited where this is necessary "to prevent harm to others," and not out of any paternalistic concern for another's interests. Difficulties with the harm principle are well-known, and will be discussed below.

Some dispute that freedom is merely absence of coercion. Instead, they believe that it requires the ability to achieve goals and make choices into realities, which is dependent on ownership of necessary resources. The difficult question is how those resources are to be supplied; the answer is usually through redistribution.

After considering different views of freedom in this section, the following section will go on to propose which view of freedom should be accepted, and how the limits to freedom should be defined.

FREEDOM AS ABSENCE OF COERCION

The idea that freedom is "The state in which a man is not subject to coercion by the arbitrary will of
another or others” is associated prominently with Hayek, who considered that this was “the original meaning of the word.”\(^5\) Coercion means “such control of the environment or circumstances of a person by another that, in order to avoid greater evil, he is forced to act not according to a coherent plan of his own but to serve the ends of another.”\(^6\)

Sir Isaiah Berlin drew a distinction between two different understandings of freedom, negative and positive. Negative freedom also employs the notion of absence of coercion. It holds that someone is free if there is an “area within which [he or she] can act unobstructed by others … and if this area is contracted by other men beyond a certain minimum, [he or she] can be described as being coerced.”\(^7\) The minimum is “That which a man cannot give up without offending against the essence of his human nature.”\(^8\) Because of its emphasis on freedom from coercion or interference, negative freedom is often labelled “freedom from.”

Hayek was careful to point out that freedom concerns relationships between humans; we are not “coerced” by our physical environment, so that a “rock climber on a difficult pitch who sees only one way out to save his life is unquestionably free, though we would hardly say he has any choice.”\(^9\) Whether someone is free, says Hayek:\(^10\)

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does not depend on the range of choice but on whether he can expect to shape his course of action in accordance with his present intentions, or whether somebody else has power so to manipulate the conditions as to make him act according to that person’s will rather than his own. Freedom thus presupposes that the individual has some assured private sphere, that there is some set of circumstances in his environment with which others cannot interfere.
\]

The requirement that coercion involve an element of arbitrariness is an important qualification. It lead Hayek to say that mere obedience to laws of general application does not necessarily make people unfree. Where legislators do not aim their laws at particular people or groups of people and law enforcers must perform their duty even-handedly, freedom is not infringed by those laws. Even laws for different groups may be justified where they are not based on arbitrary distinctions, said Hayek, giving the example of laws against rape, which treat men and women differently. Laws of this character do not privilege some and discriminate against others.\(^11\)

It would be a mistake, however, to believe that Hayek approved of every law, or that he thought laws do not hurt freedom at all. Instead, his requirement that laws be abstract and of general application, free from arbitrariness, was a way of minimising coercion, making it “as innocuous as possible.” It did not mean that coercion ceased to exist.\(^12\) Indeed, he recognised that “even general, abstract rules, equally applicable to all, may possibly constitute severe restrictions on liberty,” though he thought this risk would be negated by the requirement that the laws in question apply to the lawmakers. He concluded that law which is not an “abstract general rule” and which has the character of a “specific command,” is objectionable.\(^13\)

While Hayek’s framework may seem to leave room for targeted government policies, it does not seem that Hayek himself thought this was how it applied. In particular, he thought that a government pursuing a vision of distributive justice would necessarily be going beyond the use of non-coercive abstract general rules: “If the government is to determine how particular people ought to be situated, it must be in a position to determine also the direction of individual efforts.”\(^14\) He went on to say that:\(^15\)

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Distribution justice requires an allocation of all resources by a central authority; it requires that people be told what to do and what ends to serve. Where distributive justice is the goal, the decisions as to what the different individuals must be made to do cannot be derived from general rules but must be made in the light of the particular aims and knowledge of the planning authority.
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Taken to an extreme, the view of freedom as absence of coercion could lead to anarchy. If there are to be no restraints on conduct, it is impossible to see how society could function and how people could peacefully pursue different, and often competing goals. There needs to be some way to resolve the conflicts that will inevitably arise from the diverse uses of freedom. Hayek did not believe in such an unrestrained freedom, saying that “Coercion, however, cannot be altogether avoided because the only way to prevent it is by the threat of coercion.”\(^16\) He envisaged a role for public coercion—the government acting through laws that restrain its citizens’ freedom—to prevent private coercion—individuals constraining each other. However, as has been noted, he was concerned about the legitimate extent of public coercion through law, seeing in it an equal or greater danger to freedom.
This need for government protection against private coercion, and a framework of law to resolve conflicts between free actions, is an in-built limitation to freedom. Another in-built limitation arises simply by virtue of being human. Because people do not exist in isolation, their actions always affect those around them. Being interconnected and interdependent, people are therefore always constrained by consideration of the effect that their actions will have on others. For this reason as well, freedom cannot practically be the total absence of restraint. Such a view is incompatible with the way that people live.

Nevertheless, absence of coercion provides a good starting point for an understanding of freedom. If coercion and its absence determine whether or not people are free, then the issue of consent assumes a great deal of importance. A key element of coercion is that someone is forced to act in a certain way. If they consent to acting in that way, they have not been forced, and can be said to have acted freely in choosing that course of action.

CONSENT

Consent has been particularly important in tax history because of the centrality of the doctrine that the people must consent to taxation through Parliament. However, it is possible for someone to consent freely to something that ultimately limits their freedom of action. For example, a contract that is freely entered into still limits the range of choices available to the contracting parties, and if one of them changes their mind about the desirability of the bargain, the other party can invoke the law of contract and the courts will compel compliance with the terms of the agreement. Taxation that is consented to by Parliament allows the government to collect revenue from taxpayers by coercion. While consent may mean that the particular thing consented to is not a limitation of freedom, what is consented to may involve future limitations of freedom (see section 5). This makes it difficult to argue that taxation represents no limitation of freedom just because it has been consented to.

Consent to taxation is therefore best understood as controlling the risk of abuse of the vital power to raise public revenue,17 rather than as meaning that taxation does not represent a limitation of freedom.

After all, as Berlin saw, merely possessing “a share in the public power” does not mean that what that public power enacts does not limit the shareholder’s freedom. Instead, what is important for freedom is how much authority that public power has, and whether there are any limits that it may not cross.18 When it comes to taxation, there are no limits to what Parliament may consent to.

In any case, there are difficulties with the reality of the consent as far as individual taxpayers are concerned. “Majoritarian democracy” obviously does not amount to actual consent by individual citizens. The phrase “the tyranny of the majority” is a familiar one, and it encapsulates the ability of an electoral majority to impose their wishes on a minority. It was illustrated vividly by the new tax promised in the 1999 general election. If the only condition a government need meet in order to justify its legislation is that it was democratically elected, then “unlimited power has crept in by the back door.”19

It is also questionable whether under New Zealand’s law-making processes members of Parliament actually engage in the level of debate that would be necessary to hold that informed consent has been given by the people through their representatives. Professor Jeremy Waldron of New York University has illustrated a number of serious deficiencies in the way we pass laws, such as the lack of any requirement to actually be present at the reading of a Bill in order to be able to vote on it, and the use of closure motions to shut down debate on an issue.20 These defects are grounds for genuine concern about Parliament’s ability to exercise adequate influence or control over tax legislation, or indeed any legislation.

THE HARM PRINCIPLE AND THE LIMITS OF FREEDOM

As has been noted, treating freedom as the total absence of coercion would result in anarchy, where no limitations on actions were accepted. It is obvious that freedom must be subject to some limits, otherwise society will break down.

A century before Hayek and Berlin, Mill produced one of the most influential essays on freedom. On Liberty defined freedom as non-interference, which is similar to freedom as absence of coercion. Mill’s concern was to identify the limits of freedom or, in other words, how interference with freedom could be justified. Freedom could only be limited, Mill declared,
when actions triggered the "harm principle." In Mill's own words, "the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant."\(^{21}\)

The harm principle allows individuals "the liberty of tastes and pursuits; of framing the plan of our life to suit our own character; of doing as we like, subject to such consequences as may follow: without impediment from our fellow-creatures, so long as what we do does not harm them, even though they should think our conduct foolish, perverse, or wrong."\(^{22}\) In cases of definite harm to others, liberty can be restricted, but society should put up with "merely contingent" harm, "for the sake of the greater good of human freedom."\(^{23}\)

Mill believed his principle countenanced legal restrictions to protect rights and to require each person to pay a share of the costs "of the labours and sacrifices incurred for defending the society or its members from injury and molestation."\(^{24}\)

One central weakness of the theory is the difficulty of defining harm, which is capable of many interpretations. Another key weakness is the underlying assumption that people's actions can be individualised so that what they do does not affect others. People do not live in isolation; their actions are necessarily interconnected and so one person's choices will affect, and may harm, many. The only question is to what extent. As will be discussed in section 5, it is doubtful whether there are any truly individual actions. This is particularly the case in the modern welfare state, where individual decisions may often have consequences that result in the provision of state-funded services. For example, decisions to smoke will often send the smoker to a publicly-funded hospital. As the cost of these services is funded by general taxation, and as it seems fair to describe the burden of taxation to pay for the treatment of smoking-related diseases as a harm, Mill's principle might provide some justification for limiting smokers' freedom. The larger the scale of the welfare state and its services, and the larger the taxes required to finance those services, the more harm an individual's actions could do to his or her fellow citizens. Paradoxically, against the background of the welfare state, the harm principle may justify an increase in government intervention, rather than limiting it.

Berlin has another objection. The harm principle, he says, effectively defines freedom as "the ability to do what one wishes." But if this is correct, in the face of limitations on my freedom "I need only contract or extinguish my wishes, and I am made free. If the tyrant ... manages to condition his subjects ... into losing their original wishes and embrace ... the form of life he has invented for them, he will, on this definition, have succeeded in liberating them."\(^{25}\)

FREEDOM AS THE ABILITY TO ACHIEVE GOALS

As might be expected, it is not by any means universally accepted that freedom is simply the absence of coer­cion. It is sometimes said that freedom does not exist in any meaningful sense unless you have the ability to achieve your goals. On this view, freedom means "availability of options,"\(^{26}\) and the means to make those options a reality. Holders of this view might share the underlying sentiment in Anatole France's famous statement that "the majestic equality of the law ... forbids the rich as well as the poor to sleep under bridges, to beg in the streets and to steal bread."\(^{27}\) On this view, the formal equality of the law, which limits everyone's freedom in the same way, is simply inadequate because it fails to take any account of the options that are open to its subjects.

Rawls did not believe in such a formal version of equality, and his theory attempted to ensure that there are some limitations on freedom so that it remains meaningful. Free people, he said, are those who are "entitled to make claims on their institutions so as to advance their conceptions of the good."\(^{28}\) In Rawls' social contractarian theory, free and equal people are brought together to negotiate the rules for a fair society. Under the conditions he specified, he believed they would choose two fundamental principles of justice:\(^{29}\)

a. "Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and"

b. "Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged
members of society (the difference principle)."

Significantly, Rawls went on to say that under these principles, "no priority is assigned to liberty as such, as if the exercise of something called ‘liberty’ had a preeminent value and were the main, if not the sole, end of political and social justice."\(^3\)\(^9\) Instead, the focus is on specific "equal basic liberties," which are largely civil and political liberties such as freedom of thought and association and the right to vote.\(^3\)\(^1\)

Because of his concern that people be free, Rawls gave the "equal basic liberties" of the first principle priority over the second principle. He was also prepared to countenance inequalities in society, provided that they benefit the "least advantaged." This has been described as an attempt to preserve "the worth of liberty," on the basis that "poverty and ignorance may diminish the worth of liberty for some. This lesser worth of liberty is, Rawls argues, compensated for by the difference principle," which "seeks to protect the worth of those equal liberties for the least advantaged."\(^3\)\(^2\)

Rawls' presuppositions led him to embrace distributive justice and "fair equality of opportunity." He stated that this form of equality means that "certain requirements must be imposed on the basic structure beyond those of the system of natural liberty. A free market system must be set within a framework of political and legal institutions that adjust the long-run trend of economic forces so as to prevent excessive concentrations of property and wealth, especially those likely to lead to political domination."\(^3\)\(^3\)

In a similar vein, Hart states that:\(^3\)\(^4\)

\[\text{[I]t is of course an ancient insight that for a meaningful life not only the protection of freedom from deliberate restrictions but opportunities and resources for its exercise are needed. ... Nothing is more likely to bring freedom into contempt and so endanger it than failure to support those who lack, through no fault of their own, the material and social conditions and opportunities which are needed if a man's freedom is to contribute to his welfare.}\]

Those who agree with Rawls' and Hart's critiques might prefer a view of freedom that Berlin labelled "positive freedom." Positive freedom is also described as "freedom to," as it encapsulates the idea that freedom is the ability to achieve desired ends. Berlin connected positive freedom with the ability to achieve self-mastery, unaffected by circumstances. He saw positive freedom as particularly dangerous, as the list of circumstances that should not prevent the attainment of desired goals was open to expansion, even to the point where it included internal desires like "the pursuit of immediate pleasures." This could easily lead to the conclusion that the ends to be attained by a free person are those identified by something "higher" and therefore universal, like reason. It was, he thought, a short step from there to the view that coercing other people could be justified by saying that it was in their best interests, and that, if they would only think rationally, they would agree. "Once I take this view," he said:\(^3\)\(^5\)

\[\text{I am in a position to ignore the actual wishes of men or societies, to bully, oppress, torture them in the name, and on behalf, of their 'real' selves, in the secure knowledge that whatever is the true goal of man (happiness, performance of duty, wisdom, a just society, self-fulfilment) must be identical with his freedom—the free choice of his 'true,' albeit often submerged and inarticulate, self.}\]

Requiring that people be provided with resources and options in order to be free ultimately undermines freedom. As the state is inevitably given the responsibility of providing those things, and as it can only give what it has first taken from its citizens, coercion is expanded in the name of something described as freedom. But if freedom concerns relationships between humans, not the range of choices available to them, the justification for the increase in coercion is not freedom at all. There may be other reasons to ensure that people have at least a minimum level of resources in life, such as moral obligations of compassion, but these reasons should not be confused with freedom. It is also worth remembering that even if resources are transferred to people to maximise their ability to make choices, the choices that people actually make will very shortly rearrange that reallocation, requiring continuous and ongoing intervention to alter the consequences of people's choices.\(^3\)\(^7\) It seems a little strained to justify intervention of this sort in the name of freedom.
ENDNOTES


23 J.S. Mill, On Liberty, 76.

24 J.S. Mill, On Liberty, 70.


26 D. Green, From Welfare State to Civil Society, 54.


29 J. Rawls, Justice as Fairness: a restatement, 42.

30 J. Rawls, Justice as Fairness: a restatement, 44.

31 J. Rawls, Justice as Fairness: a restatement, 44.


33 J. Rawls, Justice as Fairness: a restatement, 44.


The preceding section introduced some of the prevailing concepts of freedom. Against that background, this section sets out to address three questions. First, having surveyed the various concepts, how should freedom be understood? Second, given that freedom cannot be absolute or unrestrained, where should its limits lie? Third, who is responsible for maintaining those limits, and how?

**HOW SHOULD FREEDOM BE UNDERSTOOD?**

It seems best to say, with Hayek and Berlin, that the absence of coercion or interference is the essence of freedom. People act freely when they are not forced to do something, when it is them, not someone else, who makes a choice. This meaning is consistent with those things generally thought of as our civil and political liberties. For example, people have freedom of expression when no-one can prevent them from speaking, and they have freedom of association when no-one can prevent them from meeting with whoever they like. By contrast, understanding freedom as free choice expands the meaning of freedom too far. For example, someone who must work to support his or her family does not have a choice not to work, but their position should not be equated with that of a slave. They still have their freedom to vote, to associate with whomever they please, and to exercise their liberty of conscience and religion.

However, there is an important connection between absence of coercion and free choice. Where freedom exists because coercion is absent, those choices that a person does have will not be limited by interference, and they will be able to choose freely among their options. As Hayek and Berlin put it, there will be a sphere within which their decisions and choices are not open to challenge. But the availability of different options and the ability to choose between them is a consequence, not a condition, of freedom.

What of the other competing versions of freedom? As discussed, some consider that freedom means that people are able to achieve their goals or to do as they like; if they are frustrated, their freedom has been limited. As Berlin points out, on this view contracting or expanding the range of goals will expand or contract the range of freedom, so that the more goals people have, the less likely they are to be free as they are less likely to have the means to achieve them. Paradoxically, coercion that results in people reducing their range of goals would result in their becoming “freer”.

Defining freedom in terms of the ability to achieve goals may also invite coercion in another way. If it is the government’s responsibility to supply the resources that make that ability a reality, this may lead to the embrace of distributive justice and may license substantial programmes of interference in private decisions and redistribution of resources through society. As has been discussed, such programmes are inconsistent with a proper understanding of justice. They are also inconsistent with a proper understanding of freedom, as they require government coercion to make them a reality.

In addition, the goals in question may come to be thought of as objective ideals that all should attain in order to be free. Berlin’s warning of the dangers of such “positive freedom” is apt. Positive freedom effectively equates freedom with power, and as a result policies ostensibly designed to enhance freedom can actually reduce it by concentrating power in the hands of those who assume the responsibility to, for example, collect and apportion...
resources to assist their recipients to achieve their desired ends.¹

We should, therefore, be cautious about seeing "positive freedom" as a species of freedom at all. Green comments that some have deliberately confused "freedom and power by distinguishing between positive and negative freedom," which he describes as "nothing but sophistry calculated to trick the unwary into surrendering their liberty in the name of freedom."²

For all these reasons, it is best to say with Hayek that freedom is measured by relationships between people, not by their environmental circumstances or the range of choices open to them.

Of course, we are not disconnected from others around us and from our environment so that we are not influenced by them at all. Instead, we are shaped and affected by others around us and by the customs and traditions of the society we live in. As the philosopher Ludwig Wittgenstein held, "the individual [is] always situated in a specific historical, existential and therefore relative social context ... an emphasis on individual autonomy [needs] to be tempered by an idea of relatedness."³ Nevertheless, within this context people still retain their moral agency; the fact of connection and influence does not mean that people cease to be free or to be responsible for their actions. It is only when the influence of other people reaches the level of coercion, forcing people to act against their will, that they can be said to have lost their freedom.

WHERE SHOULD THE LIMITS TO FREEDOM LIE?

While Hayek's and Berlin's definition of freedom is to be preferred, it is clear that there must be limits to freedom. On a purely individual level, free choices that pursue improper ends can ultimately destroy freedom and other good things. For example, a free choice to begin taking drugs may result in an addiction that allows others, such as the supplier of the drugs, to coerce the addict, whose addiction will also damage his or her physical and mental health. Some limits on freedom may therefore help preserve a larger sphere of freedom in the long run.

Crucially, the issue cannot be viewed solely on an individual level. As has been said, humans do not exist in splendid isolation from each other. They exist in relationship, interconnected and interdependent. Their choices affect all those around them, and those others’ choices affect them in turn. Ultimately the weight of every person's individual choices impacts on the whole of society. In other words, if many people in society freely choose to do wrong things, they may in the long run damage that society's fabric to such a degree that coercion is increased and freedom reduced. This demonstrates that there is a social element to freedom. Stein Ringen of Oxford University states that freedom is threatened by "the danger that we ourselves pervert it. One of the ways we are in danger of doing that is by taking liberty to be license, that we translate freedom from coercion into freedom to whatever, for example, to greed, ruthlessness, selfishness, and hubris."⁴ This creates the need for "ever more rigid rules and controls wherever we go," rules and controls that ultimately destroy our freedom.⁵

Green also points out that "a free society depends on personal responsibility."⁶ That is, if people are not responsible in how they use their freedom, they will lose it, either because the social fabric decays as the result of their irresponsible actions, or because government will restrain them to limit the effects of their free but irresponsible actions in order to prevent this decay.

A further example is that if people fail in their moral obligation of compassion to those in need and choose not to provide adequate support for them privately and through their community, the state is likely to step in to provide for the disadvantaged. This may lead to the creation of a welfare state and a redistributive ethic, something Hayek clearly considered a limitation of freedom. As Gregg points out, "there is more to a free society than just minimization of coercion."⁷ The emphasis on society illustrates that individual actions have a wider effect; simply ensuring that individuals are not coerced is not enough to ensure that society as a whole will be free.

So there must ultimately be constraints on freedom. The question is what is reasonable, permissible and necessary. While people may have liberty, they should not take it as licence, the freedom to do absolutely anything they choose. There are some things that people should not use their freedom for, because they will damage themselves and their society. As the statesman Edmund Burke said:⁸

Men qualify for civil liberty in exact proportion to their disposition to put moral chains upon
their own appetites; in proportion as their love of justice is above their rapacity; in proportion as their soundness and sobriety of understanding is above their vanity and presumption; in proportion as they are more disposed to listen to the counsels of the wise and good, in preference to the flattery of knaves. Society cannot exist unless a controlling power upon will and appetite be placed somewhere, and the less of it there is within, the more there must be without. It is ordained in the eternal constitution of things that men of intemperate minds cannot be free. Their passions forge their fetters.

The social dimension to our actions illustrates why using the Millian harm principle to define the limits to freedom is inadequate. The idea that boundaries can be placed around individual actions so that it can be said that they do not affect others, that they are merely “self-regarding” is fundamentally flawed. The distinction cannot be maintained because people are not isolated from those around them in the way the Millian principle assumes. Instead, their actions affect their families, colleagues and neighbours. Someone who decides not to work even though they are perfectly capable of it, preferring a lifetime on welfare instead, is not just making a “self-regarding” choice. Their decision has consequences for all those around them and, ultimately, for the social fabric, which is weakened when individuals fail to take responsibility for their own well-being.

A better way of defining the proper limits to the use of freedom is provided by the notion of harm to the common good. The common good is defined as “the irreducible goods which are good for every person everywhere.” These irreducible or basic goods are indicated by a society’s custom and tradition, which are those social habits and institutions which time has shown to be valuable. Natural law theory also helps identify the basic goods. Natural law philosopher John Finnis, for example, considers that there are seven “basic goods vital to the flourishing of people everywhere,” and which are “self-evident, being accessible to human intelligence through observation and human reason.” They are “life, knowledge, play, aesthetic experience, sociability (friendship), practical reasonableness and religion (spirituality).” The common good therefore involves “the flourishing of all people in community together. This means that there is more to the common good than maximising one good because it is a product of each person living well in association.” What harms the common good is what is counter to the basic goods or “wrong in relation to the moral order.”

A full discussion of the common good can be found in the first discussion paper in this series.

The point is that freedom should not be used in a way that harms the common good, because this would mean acting in a way that undermines the basic goods which are valuable for all people. It would damage both the person acting, and those around them; that is, it would damage the social fabric. Because it is able to take account of the social and moral dimensions to people’s actions, this harm principle provides a better account of the limits of freedom than the Millian version. Put simply, it means that people should use their freedom responsibly in a way that pursues, or at least does not undermine, the constituent elements of the common good.

Using freedom responsibly is ultimately what sustains freedom. The point has already been made that if liberty is treated as licence, as unrestrained freedom, the chaos and social destruction that will inevitably result will equally inevitably require government restraint. So the responsible use of freedom removes the need for government action that restricts freedom.

Responsible freedom also sustains freedom in another critical way. Free actions that either enhance, or at least do not damage, the common good will also strengthen the social fabric and “the associative communities and institutions of civil society.” These communities and institutions “can be a bulwark against the growth of the state.” Earlier this discussion paper noted de Tocqueville’s belief that “associational bonds [would] allow people to restrict unwarranted extensions of State power,” and that the associative communities and institutions of civil society would form “the independent eye of society,” scrutinising government and resisting its incursions into liberty. When the government attempts to push in beyond its proper role and interfere with people’s liberty, strong communities will be able to push back and maintain freedom.

In summary, people are free when they are not coerced by others, when they can act unobstructed by others within a certain sphere. But they should not use their freedom irresponsibly. To be precise, they should not use it in a way that harms the common good. This harm principle indicates what should be the limits of freedom, and raises the question of
controls on freedom. There are, of course, two ways that freedom can be controlled—self-control or control by government.\textsuperscript{18} The question that arises now is, who should be responsible for the use and control of freedom?

**WHO IS RESPONSIBLE FOR CONTROLS ON THE USE OF FREEDOM, AND WHY?**

Individuals and government each have a role to play in controlling and limiting freedom where to do so is necessary to protect the common good, as outlined above, so that it is not used in a way that is ultimately destructive. The responsibility should rest in the first place with the individual. There are two main reasons for this. The first is that, until the individual has acted, there may not be any harm to the common good that the government should limit. The second is that government action has particular dangers and limitations associated with it. They are discussed further below; for now, the point is that the more people use their freedom responsibly, the less need there will be for government to restrain them, and the less those dangers and limitations will apply.

The point which justifies government limitation of freedom, and which defines the boundary around the private sphere of freedom, is when there is a threat of harm to the common good. Government is justified in limiting the scope of people's freedom when this is necessary to protect the common good against such a threat.\textsuperscript{19} However, two crucial limiting factors qualify the government's power to respond to the threat. The first is that in responding, government should respect the custom and tradition of the society it governs. Proper custom and tradition "indicate which social arrangements are good for a community and should be conserved."\textsuperscript{20} For example, government is not justified in undermining the family in order to respond to some threat to the common good, because custom and tradition have revealed the value and importance of the family to a strong and flourishing society. In this way, custom and tradition also help to illustrate the content of the common good that the government is to protect.\textsuperscript{21}

The second limiting factor is found in the principle of subsidiarity. This principle holds that "the associative communities and institutions of civil society" have their own sphere of authority and responsibility, according to their "leading function."\textsuperscript{22} Further, it means that "government should not intervene unless ... associative communities cannot deal with the threat of harm themselves."\textsuperscript{23} This means that government is not automatically justified in responding to a threat of harm—it must first be demonstrated that the community and the bodies within it are unable to respond after a proper opportunity. Subsidiarity therefore functions as a reminder that not every problem requires a government solution. In addition, subsidiarity means that a government's intervention should be temporary and limited to the duration of the threat to which it is responding. When the threat has passed, the need for government intervention is over, and government should withdraw rather than become entrenched in the communities it is supporting.\textsuperscript{24}

When these qualifying conditions are satisfied, the limitations on freedom involved in government intervention will be justified. If they are not satisfied, the limitations will not be justified. This might occur when government moves from protecting the common good from harm, to attempting to promote its ideal of the good, steering people towards goals and ends that it believes they should be forced to pursue, or simply imposing what it thinks is right upon its citizens. Government that acts in this way goes beyond its legitimate function. It slips into the realm of positive freedom, with all the dangers that this entails.\textsuperscript{25} The prohibition on government promoting the common good means, for example, that governments should not redistribute wealth between members of society simply to implement some grand vision of the good society based on a utopian ideal of material equality. The justification for redistribution is limited to necessity to meet the threat to the common good posed by genuine material need and deprivation.

The problem with attempts to promote the common good lies in the fact that the elements of the common good can be pursued in multiple ways at different times, with different weightings allocated to each element by different people. However, when government tries to promote the common good, it prescribes a particular way of achieving the common good that it believes is best. This might be quite incompatible with the way in which many of its citizens would choose to pursue the common good. Because the common good is composed of irreducible basic goods which cannot be collapsed into each other, it is impossible to come up with any formula or metric that would allow government to prescribe the
government assists people’s liberty; it does not create liberties for people. ... If its purpose is to protect the good, government should not have a mandate to push in and pursue public goals. This principle is in stark contrast to the Aristotelian view that government’s role is to impose an abstract grand design from above upon civil society, whereby the societas perfecta (the self-sufficient state) would be established.

This framework prescribes a limited role for the government, one which reduces the degree to which government can coerce its citizens. The framework should make it clear that one of the most important ways government can secure its citizens’ freedom is by respecting its own boundaries and not expanding into their lives. This is particularly the case given the limitations to government action; in particular, the problems of abuse of power and unintended consequences. The more the government takes on, the more power it acquires. As government pushes into and engulfs other institutions and communities of society, their ability to constrain government, to act as a fully “independent eye” capable of moderating public power, reduces further and further. The risk that government power will be abused therefore multiplies as government grows stronger and society grows weaker. Government action also results in unintended negative consequences. For example, attempting to support families with children through the Working for Families welfare programme creates “poverty traps” (discussed in section 6) that act as a disincentive for families to work harder and increase their income to support themselves, thus cementing their reliance on the state for income. Government should always be realistic about the wider effects of its interventions.

Having said all this, the framework for the role of government implies that government has some crucial responsibilities with implications for freedom. Government should be responsible for “enacting public justice.” By maintaining legal frameworks and institutions that prevent people using their freedom irresponsibly—that is, in a way that harms the common good—and that resolve conflicts between people, government assists people to thrive together in community. People have competing desires and goals which bring them into conflict. In a complex society, a framework of order and authority is necessary if people are to co-exist peacefully. In other words, “there cannot be liberty without order. There is always a correlation between freedom and authority, even though a measure of people’s liberty might be denied to them by allowing government to protect public justice.” However, in doing this government should be mindful of the authority and responsibilities of the associative communities within their own spheres. Gregg puts it this way:

If we are to flourish as human beings, we need to be able to act under our own volition. Yet, we cannot do so if our decisions are constantly pre-empted for us by the State. On the other hand, our opportunities for free choice may be unreasonably limited if certain prerequisites such as public order and rule of law, which rely heavily on State authority for their efficacy, are absent.

For example, the government is justified in legally prohibiting drug use, even though this limits the would-be user’s freedom. If drug use is allowed to become prevalent, the damage that it does will weaken the social fabric and erode the common good. While there is certainly a role for individuals and communities to create an environment which militates against drug use, the problem and the threat is one that properly requires the attention of central government through law. Similarly, laws which enforce contracts are justified even though they reduce contracting parties’ freedom to choose to act differently to the terms of their bargain. Contracts are an important way in which individuals and organisations can enter into exchanges or collaborate to pursue elements of the common good. If they were not enforced, people’s ability to pursue the common good and its constituent elements would be lost. Custom and tradition recognise that it is important and right that people should honour their promises, and enforcement by government is necessary to provide effective sanctions against contract-breakers who might not be deterred by community disapproval, and to resolve genuine disputes about the terms of the agreement between the parties.

Government also has a responsibility “to foster association and community.” As has been discussed, “the associative communities and institutions of civil society” prevent the government from expanding beyond its proper role to the point where it unjustifiably limits people’s freedom. If
the government is able to act in a way that enables them to be strong, this will help to preserve freedom. The primary way that the government can do this is by providing public justice and maintaining the frameworks that will allow those associations and institutions to flourish, rather than taking over their roles and making their members dependent on the state.

Government is also responsible for providing the necessary environment for “an entrepreneurial culture” to flourish. Such a culture enhances wealth creation, which benefits the whole of society by providing employment and resources. Again, the primary action the government should take is to provide public justice and maintain the frameworks of order and authority necessary to allow co-ordinated activity and the resolution of conflicts. This will allow entrepreneurs to do what they do best, rather than attempting to direct their efforts with subsidies and regulations or creating “regulatory and tax barriers” to their efforts.

Government should also be responsible for providing what economists call public goods, “measures which government can provide by means of regulation, funding or provision more efficiently than individuals or local communities,” if they are goods that are “essential for the well-being of society which the community cannot provide on its own.” Public goods have two distinctive features. First, they are “non-excludable,” meaning that it is difficult to prevent people from using them. Second, they are “non-rival,” meaning that people do not have to compete to use them because use by one person does not prevent use by another. Street lighting is an example of a public good, as is national defence. There are also quasi-public goods, which have only one of the distinctive features of public goods. For example, roads may be excludable through tolls but non-rival (unless congested). Public goods and quasi-public goods may legitimately be provided by government where they will be under-supplied, or not supplied at all, by private producers. Providing these public goods and quasi-public goods may involve some limitation on freedom—for example, imposing taxes to fund their provision—but it may also enhance freedom as the public goods provide the order that freedom requires—for example, providing police and courts to enforce and apply the law will help keep citizens free of the coercion of criminals. Even to the extent that supplying public goods and quasi-public goods involves limitations of freedom, these limitations are justified to the extent that they are necessary for the government to fulfil its role in protecting the common good from threats of harm.

In summary, individuals and government have important roles to play in the responsible use of freedom and the creation of workable limits to it. Individuals are primarily responsible for the way freedom is used, and the more they use their freedom wisely, the less need there will be for the government to limit it. However, humans do not always act reasonably or wisely, and when their failures threaten the common good of society, the government has a role to play in responding to the threat and enforcing the limits to freedom that are needed if people are to live well in society. Nonetheless, government intervention should be limited, because of the loss of freedom that it involves and its potential side-effects, such as the abuse of power and unforeseen negative consequences. Intervention can only be justified in accordance with the government’s role to protect the common good from identifiable threats of harm in a way that is consistent with proper custom and tradition and the principle of subsidiarity.
ENDNOTES


2 D. Green, From Welfare State to Civil Society, 55.

3 P. Henderson and J. Fox, Silent Legacy: The unseen ways great thinkers have shaped our culture, (Auckland: Maxim Institute, 2008), 182.


5 S. Ringen, What Democracy is For: On freedom and moral government, 201.

6 D. Green, From Welfare State to Civil Society, 19.

7 S. Gregg, On Ordered Liberty, (Lanham, Maryland: Lexington Books, 2003), 243 (emphasis added).


12 S. Thomas, “Governing for the Good: What does it really mean?” 75.

13 S. Thomas, “Governing for the Good: What does it really mean?” 34.


17 S. Gregg, On Ordered Liberty, 93.


22 S. Thomas, “Governing for the Good: What does it really mean?” 26, internal citations omitted.


30 S. Gregg, On Ordered Liberty, 74.

31 S. Thomas, “Governing for the Good: What does it really mean?” 52.


34 S. Thomas, “Governing for the Good: What does it really mean?” 57.


Having considered the competing conceptions of justice and freedom, we can look at specific policies to see how they measure up against a proper understanding of these conceptions. Perhaps the main way that tax policy tries to give effect to concerns about fairness, particularly equality, is progressive personal income taxation, which emphasises redistribution. As this involves a focus on outcomes, the policy is problematic on justice grounds. Progressive taxation also opens the tax system to the tyranny of the majority, where the freedom of a minority is limited in the interests of a majority. It does this by allowing the bulk of taxpayers to make a smaller group subject to a different tax rate than the larger group has to bear. The redistribution that progressive taxation allows also limits freedom.

Mechanisms such as targeted tax incentives also bring into question issues of fairness and justice, as they too involve redistribution and the selection of favoured groups of recipients. Tax incentives also raise issues of freedom. The increasing reliance on tax incentives seems to reflect an increasing desire to direct citizens’ behaviour. Incentives for working, retirement saving and charitable giving have all been introduced or increased recently. Each incentive has to be considered on its merits—that is, whether it is necessary to meet a threat to the common good, while appropriately respecting the authority and integrity of civil society—but the pattern of reliance on incentives raises questions. Not only can incentives weaken the personal responsibility and independence that are necessary to sustain a flourishing community, they may cause more problems than they solve.

Even apparently neutral tax policies such as GST can attract charges of unfairness. This section will consider whether they are well founded. It will also consider whether there are good arguments for changing the tax mix to lessen the degree of reliance on income taxation and increase the proportion of total tax revenue that comes from GST.

It is also important to consider what tax is spent on. The collection of taxes involves a limitation of freedom, but this will be justified if those taxes fund government activities that are necessary and effective to protect the common good from harm and that are carried out in a way that respects custom and tradition and the principle of subsidiarity. Working for Families is examined to see whether government expenditure on it passes this test.

The level of taxation is also important. High taxes induce reliance on the government for provision, and allow it to direct people’s behaviour by attaching conditions to the financial assistance it provides. Ultimately this weakens civil society, which comes to rely more and more on the state for direction and provision.

Having considered these policies, this section will conclude with some possible directions for policy reform, a subject that will be taken up in more detail in a later paper in this series.

**PROGRESSIVE PERSONAL INCOME TAXATION**

Progressive taxation is a means to an end or, in the language we have used so far, an outcome. It is often employed in an attempt to achieve a particular view of fairness, especially greater income equality. This was made very clear in the delivery of Budget 2008, where the tax cuts package presented by the Government made the personal income rate scale more progressive by widening the gap between the top rate and the bottom rate (see Table 6.1 overleaf). While the effect was to some extent mitigated by...
Is it Just Tax? The shaping of our society

raising the thresholds at which the various rates apply, the underlying commitment to take a greater proportion from “the rich” than from “the poor” is clear.

Because the taxes taken from “rich” and “poor” alike pay for public services that are available to all, the effect of requiring some to pay a higher price for those services than others is to redistribute wealth between them. The effect can be even more pronounced when the public services in question are not available to all. Redistribution also occurs when the income that is collected is transferred directly to selected recipients.

The discussion earlier in this paper indicates that many New Zealanders may quite like this Robin Hood approach. However, Australian research has found that fewer than half of taxpayers “know that low-income earners pay a smaller proportion of their income in income tax than higher earners do,” and that nearly a third believe “that low-income earners pay a greater proportion of their income in income tax than higher earners do.” This finding casts some doubt on whether taxpayers understand progression sufficiently to really “value the progressivity delivered through the tax system.” In any case, the premises underlying progressive taxation are questionable, and a greater understanding of these premises may shake the confidence that some people place in progressive taxation.

To the extent that it is a way to alter the pattern of income distribution across society, progressive taxation requires the government to “continually (or periodically) interfere to take from some persons resources that others for some reason choose to transfer to them.” This means that individuals and groups are treated unequally in the name of redistribution. It might be argued that the idea of progressive taxation is consistent with justice because it adjusts the tax burden to allow for need. There may be some truth to this, but the current progressive rate scale does not seem to be based tightly, if at all, on an identifiable level of need such as a poverty line, as tax rates continue to vary well above any such level.

In addition, none of the specific measures of outcomes support progressive taxation above other tax policies. Even if ability to pay is accepted as a reasonable yardstick for tax policy, it does not require progressive taxation ahead of a flat tax. A flat tax on income will still see “the rich” paying a higher total sum in tax than “the poor.” Ability to pay would need to increase at a faster rate than income to justify a progressive tax rate on income. But where income is the measure of ability, that cannot be shown.

Even to the extent that it tries to achieve equality of outcomes, progressive taxation is limited. In New Zealand, it only applies to personal income, which is a restricted measure of outcomes. Income is not necessarily a very good indicator of people’s circumstances or their need. “A household may have little taxable income but substantial assets (such as land, savings or investments).” Conversely, they may have a relatively high income and numerous liabilities and financial commitments, such as those associated with bringing up a family. Personal income tax is assessed on an individual basis, so

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**Table 6.1. The new personal income tax scale**

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For example from 1 April 2011, an individual earning $40,000 pa pays 12.5% tax on the first $20,000 of income and 21% tax on the remaining $20,000.

Source: The Treasury, “Budget 2008: Key facts for taxpayers”
it does not take account of household or family circumstances. As has already been noted, the effect of this restricted focus on one measure of outcomes may even make people more unequal by increasing “inequality of lifetime earnings,” especially as the focus is artificially restricted and segmented by each financial year. “Crude money egalitarianism” also fails to take into account people’s free choices—such as to prefer lower income and more leisure time—and, as a result, can unreasonably benefit those who have chosen lower income at the expense of those who have chosen higher income, with the overall result that these people are made unequal.

The restricted focus on income also fails to take account of the pattern of government spending. As we have seen, the greatest benefits of government spending accrue to those who pay the least tax, while those who pay the most tax receive the fewest benefits. Yet debate about the appropriate rate scale for personal income often proceeds on the basis that “the rich” should pay more in tax and “the poor” should pay less, without any reference to the relative tax-funded services that each of these two notional groups receive. This is not to query the provision of public services to those in need. Rather, the point is that a meaningful debate about taxation must also take account of the size and scale of government provision, and its recipients. This might include questioning whether this difference in provision is actually linked to need, or whether it is simply designed to achieve an outcome like greater material equality.

A key justification for progressive income taxation has been the idea that it is required so that taxpayers at varying levels of income make equal sacrifices. The underlying concept is that money has a declining marginal utility which can provide a firm basis for progressive rate scales. However, as has been discussed, the key problem is that the fact of declining marginal utility cannot be proved, despite its initial plausibility. The idea appears most plausible when comparing the sacrifice that a dollar represents for those in poverty with the sacrifice that it represents for those who are not in poverty. But to justify a progressive taxation curve that applies to the majority of taxpayers who are not in poverty, it would need to be shown not only that money has declining marginal utility for all of them, but that “the same declining curve [applies] to all taxpayers.” This, too, is unprovable.

In reply, it might be said that the idea of declining marginal utility has “operational meaning” as a practical foundation for taxation. Similarly, it has been said that “Rough guesswork will be a part of any plausible account of tax justice ... As the economist Amartya Sen has said, ‘it is better to be roughly right than precisely wrong.’” The response to this, however, is that knowing only that money has a declining marginal value is insufficient. If the tax rate scale is supposed to mirror the declining utility curve, we need a good idea of the shape of that curve. Without it, the rates we select may do a worse job of approximating an optimal scale based on the curve than a flat tax would.

In addition to the way that it poses issues of justice by prioritising outcomes over fair and equal treatment, progressive taxation has implications for freedom. To begin with, it creates the possibility of the tyranny of the majority. Because some taxpayers are required to pay a higher proportion of their income in tax than others, a majority of taxpayers can impose a higher burden on a minority than they themselves have to bear, as was the case with the introduction of the 39 percent tax rate following the 1999 general election, a pattern that is maintained in the current personal income tax rates.

This is not a new issue. James Madison, one of America’s Founding Fathers, was concerned in the 1780s to design a constitutional structure that would control the effects of “factions” in society and prevent them from exploiting political power at the expense of others. He believed factions posed a particular danger in “the apportionment of taxes,” saying that this was “an act which seems to require the most exact impartiality; yet there is, perhaps, no legislative act in which greater opportunity and temptation are given to a predominant party to trample on the rules of justice. Every shilling with which they overburden the inferior number is a shilling saved to their own pockets.”

It is for this reason that some have advocated limits on taxation to fix the maximum rate in a way that reduces the potential for exploitation. In the
1950s there was “a proposal to amend the [United States] Constitution to limit the rates of federal income taxes by imposing a ceiling of twenty-five per cent.”14 A few years later, Hayek suggested that the top permissible rate should be “fixed ... at that percentage of the total national income which the government takes in taxation. This would mean that if the government took 25 per cent of the national income, 25 per cent would also be the maximum rate of direct taxation of any part of individual incomes.” This rule would still allow for progressive taxation, but reductions in the rate for lower incomes would only be to the extent necessary to compensate for any regression in indirect taxes.15 In other words, everyone would bear the same tax burden, including those who voted for it, limiting the potential for abuse. Flat taxes are another way to address this problem. Under a flat or proportionate tax, everyone pays the same rate, so those who support the tax will be subject to the rate they impose on others. This removes the temptation to “overburden the inferior number” of taxpayers. Even mildly progressive—flatter, but not flat—taxes would help to reduce the problem, as they reduce the size of the additional burden that the minority is subjected to.

To the extent that progression attempts to achieve greater income equality by taking from “the rich” to give to “the poor,” it limits freedom. Maintaining a favoured pattern of resource distribution requires on-going government intervention in taxpayers’ lives to maintain the pattern.16

Progressive taxation’s intention to take more from “the rich” may also cause problems in another way. It can have the effect of penalising productive work and people’s efforts to get ahead and improve their lives on their own initiative. As income increases because work hours are increased, skills are gained or extra responsibility is taken on, higher taxes take a larger proportion of the extra income earned, and this in theory may reduce people’s motivation to earn that income in the first place. However, this is a hotly contested subject, and actual results are difficult to measure because two competing factors are at work in such a scenario: the “income effect” and the “substitution effect,” discussed earlier in section 2.

It is also difficult to tell what effect tax increases or decreases have on work output because income and leisure are not the only relevant factors. For example, an employee may have to work a set number of hours per week regardless of tax rate changes.17 Blum and Kalven caution that “The degree to which progression tends to lower productivity is inherently difficult to gauge,” and that it is important not to conflate the issue of increasing marginal tax rates “with the undesirable economic consequences which flow from high taxes generally.”18 Nevertheless, Davidson has concluded that there is evidence “that high marginal tax rates impact adversely on work incentives ... but it relates mainly to workers in specific situations—second earners in households, self-employed people who can easily vary their hours, and highly-paid autonomous professionals.”19 For these people at least, progressive taxation may force them to make different decisions about their working hours than they otherwise would.

High marginal tax rates at the top of the progressive scale may also have negative effects on entrepreneurs, whose investment in new ventures plays a critical role in wealth creation and the creation of new jobs. Blum and Kalven considered that progression had “repressive implications” for investment but, as with the income and substitution effects, “there are many other influences at work in shaping the decisions of potential investors.”20 Consequently, the level of tax, rather than the fact that it is progressive, may be more significant for investment decisions and entrepreneurship. Nevertheless, to the extent that it does play a part in influencing investment decisions, progressive taxation may act as a barrier to investment and wealth creation, which may have the long-term effect of making people more reliant on government provision, rather than allowing them to provide for themselves.

Are there better alternatives to progressive taxation? While it is not the purpose of this paper to explore alternative policies in any detail, a proportionate or “flat” tax would avoid the problem of treating taxpayers unequally. Under a flat tax, everyone would pay the same rate of tax on their income, regardless of the level of their income. A flatter tax, one that is still progressive but which has fewer income brackets, would also reduce the problem of unequal treatment. Along these lines, the McLeod Review recommended the adoption of “a two-rate tax scale with ... rates of 18 percent and 33 percent.”21

On the subject of flat taxes and equal treatment, Davidson has this to say:22

In his discussion of taxation, Hayek argues that
Section 6 | Policy Implications

Proportional taxation is intuitively fair, while progressive taxation is arbitrary and unjust. In particular, he maintained that proportionality ‘provides a rule which is likely to be agreed upon by those who will pay absolutely more and those who will pay absolutely less’. Adam Smith similarly supported proportional taxation because it rested on a commonly understood criterion of fairness as equal treatment, and John Stuart Mill wrote, ‘I can see no fairer standard of real equality than to take from all persons, whatever may be their amount of fortune, the same arithmetical proportion of their superfluities.’ There is, therefore, an intuitive sense of ‘fairness’ in the idea of proportionality that is completely absent in progressive taxation systems.

A flat, or flatter tax may not meet concerns for the disadvantaged by itself. Measures such as a tax-free threshold on personal income up to the poverty line, and a flat tax on income above it, may be appropriate policies to give effect to the moral obligation of compassion. Some object to such a policy on the basis that “low taxable income is not a good proxy for need,” and that a better policy would be to target assistance to those in need. A zero tax bracket will benefit not just those who earn below the bracket’s threshold and who have been identified as being in need, but all those above the threshold as well. For example, if the first $20,000 of income is tax-free, someone earning $100,000 benefits from this policy by only having to pay tax on their last $80,000 of income. And if existing levels of government revenue are to be maintained, or at least are not to reduce too greatly, rates above the zero tax bracket may have to be increased. This raises concerns about the effect of increasing tax rates on valuable, productive behaviour, such as increased work effort, though this is a controversial and complex issue. Nevertheless, the idea of a tax-free bracket may be worthy of further exploration.

Despite the objections outlined above, such a policy embodies the idea that government should not collect tax from those in genuine need, especially if that tax will have to be recycled to them in the form of benefits. And it should not simply be assumed that existing levels of revenue are to be maintained. If a tax-free bracket replaces a certain level of benefit expenditure, then at a minimum the taxes collected to fund that expenditure will no longer be needed. In addition, there may be a more general case for reducing the level of government tax and expenditure, as discussed in the first paper in this discussion series.

It should also be noted that a flat or flatter tax does not preclude assistance to the needy. As the McLeod Review pointed out, government spending, not taxation, is the main engine of redistribution, and so redistribution could occur even under a flat tax. Targeted government assistance programmes have problems of their own, however, such as increases in effective marginal tax rates and abatement problems for those attempting to come off government support.

Whatever conclusions might be reached about policy reform, it appears that the current progressive personal income tax is not clearly linked to identifiable need. It strays into the territory of unjustified redistribution and limitations of freedom.

Incentives

The OECD’s Economic Survey: New Zealand 2007 noted that “the government has increasingly used the tax system as a tool to deliver on other policy objectives. This has complicated the tax system and has had some adverse effects on individual economic behaviour.” This had been done through the introduction of a number of different incentives designed to encourage taxpayers to behave in ways that are believed to be desirable, such as working, having a family, or saving. Examples include the Working for Families tax credits, KiwiSaver tax credits and subsidies, new charitable tax incentives, and “sin taxes,” all of which are considered below.

Leaving aside questions about whether they are effective for this purpose and whether the desired outcomes are appropriate, tax breaks such as these raise questions of fairness as they are outcomes-focused, treating people unequally in the attempt to favour certain outcomes. It is worth bearing in mind that this means disadvantaging groups that are not eligible for the tax concessions in favour of groups that are eligible. As Murphy and Nagel note, “Any tax break is a redistribution from those who don’t get it to those who do.”

Tax incentives can greatly distort the effects of tax rates, altering tax incidence and therefore affecting our assessment of whether a tax system is fair. For example, the personal income rates that applied up to 1 October 2008 took 28.1 percent of a salary of $80,000 p.a. in tax, but only 21.6 percent
of a salary of $45,000 p.a. If those salaries were the only income in two families, each with two dependent children, the family whose income is $80,000 “pays 14 times more tax than [the] identical family earning $45,000, after taking into account Working for Families.” The effect of this year’s Budget tax cuts and increases in Working for Families is that “a couple with two children [aged 11 and 18] would need to have a combined household income of $52,700 a year before they are paying any income tax in net terms in the tax year 2009/10 and $57,200 a year in 2011/12.”

Because they prioritise favoured outcomes over the standards of equal treatment, tax incentives do not meet the requirements of justice. It is also worth noting that the same issues of justice would arise even if the delivery mechanism was different, that is, even if direct grants or subsidies were used rather than incentives administered through the tax system. The effect and intent is the same in either case. The issue, therefore, is whether they can be justified as compassionate measures assisting those in genuine need.

If so, that will be an indication that the taxes required to fund these incentives are a justified limitation of freedom. However, the increasing reliance on incentives has taken place with little or no public debate about whether it is appropriate to attempt to direct people’s behaviour in this way. Of course, taxation always affects behaviour to some degree. For example, reducing the benefit received from work by taxing income from it may alter people’s decisions about the hours they work, or may induce their employer to remunerate them in “tax efficient” ways.

But although side effects such as these do affect people’s freedom, they are very different to the “tax as a tool” approach, which involves deliberate attempts to influence behaviour through targeted tax policies. Though tax incentives do not command or prohibit certain courses of action outright, they nevertheless represent a subtle limitation of freedom, structuring the choices available to people and attempting to guide their conduct. There is a risk that they will erode people’s sense of responsibility and independence of thought and action, leaving them dependent on central government for direction and purpose.

Working for Families

Working for Families is an example of a policy that is not well targeted to those in real need. It is a programme of government assistance to families with dependent children, with “the goals of improving income adequacy, making work pay and ensuring families get the assistance they are entitled to.” Its key elements are the Family Tax Credit (formerly Income Support), the In-Work Tax Credit, the Accommodation Supplement and Childcare Assistance. Working for Families was introduced in 2004, and it now provides over $2.7 billion of tax credits “compared with payments to families of $1.0 billion in 2004, prior to the introduction of the [Working for Families] package.” After its introduction, Working for Families was extended in 2005 “by raising the income threshold and lowering the rate of abatement for income in excess of the threshold.” The effect of these changes was that:

These enhancements were expected to provide additional [Working for Families] Tax Credits to an estimated additional 160,000 families, including 60,000 newly eligible families. These families have higher incomes than the previous target group. By 1 April 2007 nearly all families with children earning under $70,000, many earning $70,000 to $100,000, and some earning more, qualified for [Working for Families].

Official statements advise that Working for Families “is putting more money in the pockets of many low- and middle-income families through increased tax credits.” While this may be true, it is clear that Working for Families is also capable of “putting more money in the pockets” of high-income families. In fact, “Working for Families is not primarily an anti-poverty package. The biggest increases in cash assistance under Working for Families are not accruing to families with incomes below the poverty line. Rather, families with incomes somewhat above the poverty line receive most of the money in the package.” In addition, Working for Families may prevent some families from increasing their incomes by taking on higher-paying work, due to the problem of “poverty traps” and high effective marginal tax rates, an issue that will be discussed below.

The latest Ministry of Social Development evaluation of Working for Families finds that over 370,000 families are receiving it, which represents “around three quarters of New Zealand families with
Twenty three percent of recipient families have a household income greater than $50,000, and approximately half of recipient families have a household income greater than $30,000. Forty nine percent of recipient families are “non-beneficiaries,” meaning they “do not receive any income from a main benefit.”

These are good grounds to query whether Working for Families is well targeted to need, and concerns arise over the fact that some of those from whom income is being redistributed are themselves in need, but ineligible for the Working for Families tax credits because they do not have children. As Dwyer notes in his analysis of Working for Families, “Redistribution can make some people better off but only at the cost of making others worse off.”

Dwyer also notes that: Redistribution from single people and families without dependent children to families with children on low to middle incomes largely transfers income between different stages in people’s life cycle. Single people largely consist of the young and the surviving spouse of a former couple. Similarly, income redistribution between families with children on high incomes and those on lower incomes tends to reallocate income between younger families and older families. Much of the Working for Families package is likely to constitute such redistribution. The grounds for redistribution, beyond the alleviation of hardship, are doubtful.

Because Working for Families does not target need well, and because it is outcomes-focused, the scheme as a whole cannot be justified on either equal treatment or social justice grounds. It would need to be much more tightly targeted to genuine hardship before it could be supported on the grounds of compassion and social justice, and even then it would need to be shown that the need was one the community could not meet. There are serious grounds for reconsidering the justice and fairness of Working for Families.

Supporters of Working for Families might say that the policy should be upheld on the basis that it responds effectively to concerns about child poverty and income inequality. They may also say that the policy is structured in such a way as to reduce the problem of dependence on welfare benefits, because it is intended to incentivise work.

Poverty and welfare dependency are certainly legitimate concerns, though income inequality by itself is not, for the reasons given earlier in this paper. Although the policy is not well targeted to poverty, it nevertheless appears to have had a substantial impact on rates of child poverty in New Zealand, which have fallen significantly between 2004 and 2007 according to one report. Working for Families was expected to reduce reported child poverty rates by 30 or 70 percent, depending on the poverty measure used, and these predictions did not take account of the expansions of Working for Families that occurred after its introduction in Budget 2004. Bryan Perry of the Ministry of Social Development has reported a proportionate fall in child poverty of between 27 percent and 36 percent when the poverty line is fixed and between 9 percent and 23 percent when the poverty line is adjusted to reflect changes in relative incomes. Although these changes also include the effect of increased employment and economic growth, and are for a period that does not fully capture the implementation of Working for Families, it appears that Working for Families has had a significant impact. This is not entirely surprising because as Dwyer noted, significant decreases in poverty were predicted as a result of Working for Families, but this was primarily because many families’ incomes at that time were “just below the lower poverty benchmark or between both poverty lines ... Thus modest increases in the incomes of such families have a large effect on the forecast level of poverty.” While a reduction in the rate of child poverty is to be welcomed, questions remain about the targeting of the programme, given that it “has led to increased receipt of assistance by families above the poverty line.”

In fact, this means that the policy exacerbates the problem of welfare dependency. This is because it is itself a form of welfare, increasing families’ reliance on the state for a portion of their incomes. Working for Families actually creates “poverty traps” for families with children. Economist Patrick Nolan says that these “Poverty traps occur when there is a range of hours of work where, due to taxation and the clawback of assistance, there are few or no financial incentives for people to enter into or remain in work, or to increase their hours of work or wage rates.”

These poverty traps are also described in terms of effective marginal tax rates (EMTRs). These EMTRs are produced by the simultaneous effect of increasing tax rates and decreasing benefit rates. EMTRs are
Is it Just Tax? The shaping of our society

...are widely available and is received by “around three quarters of New Zealand families with children.” Dwyer notes that this wide-ranging extension of welfare to the majority of New Zealand families has:

extend[ed] high EMTRs much further up the income distribution, while doing little to alleviate the problem of high EMTRs as people transition from benefits to work. Families with dependent children risk being locked into high EMTRs over wide ranges of income, from which many will have difficulty escaping, even in the medium term. This is a key weakness of [Working for Families].

In practical terms, a parent contemplating an offer of promotion that will increase their hours or their responsibility at work is likely to think twice once they realise that the accompanying salary increase will reduce the amount of assistance they get from the government, assistance that does not require any effort on their behalf. Similarly, a potential secondary earner contemplating entry into the workforce may be deterred by the fact that, as their household income increases, their Working for Families payments will decrease. Scenarios such as these reveal that the EMTRs associated with Working for Families are likely to affect people’s decisions by deterring them from productive activities. The problem is exacerbated by the fact that the “abatement zones” associated with Working for Families are likely to affect people’s decisions by deterring them from productive activities. The problem is exacerbated by the fact that the “abatement zones” associated with Working for Families—the range of income over which the level of assistance decreases—“coincide with a very common income range among New Zealand families.”

A further problem is that Working for Families appears to increase the problem of marriage or partner penalties. These penalties “occur when two parents (or spouses) have a higher total income ... when separated than when a partnered unit.” Working for Families “has extended the reach of partner penalties up the income scale and made them larger for middle-income households than they were before.” It is not certain whether marriage or partner penalties have a direct effect on decisions to marry or cohabit, but some studies suggest that they do. However, the effect is unclear because many other variables influence those decisions.

Dwyer also queries whether Working for Families will be effective at encouraging employment, commenting that “Most spending on [Working for Families] will not increase the return [that is, the income gained] from work. Moreover, most of the cost of the [In-Work Payment] will comprise payments to families already in employment, including families that have a strong commitment to work.” In the final analysis, the effects of attempting to encourage employment through Working for Families “are small, costly and likely to be offset by lower employment than otherwise elsewhere in the economy.”

A good portion of the total government spending on Working for Families therefore represents a wasteful use of public money that could have been allocated to measures that would increase economic growth and raise living standards. Although Working for Families appears to have had an impact on child poverty rates, it is important to consider the impact that lower levels of sole parenthood and higher rates of employment and economic growth can also have on child poverty, measures that do not suffer from the same flaws as government transfer programmes such as Working for Families.

KiwiSaver

KiwiSaver raises similar questions about the targeting of its subsidies. KiwiSaver is a work-based retirement savings scheme established by the KiwiSaver Act 2006. It works on an automatic enrolment, “opt-out” basis. In other words, employees are automatically enrolled in the scheme and begin making contributions when they start a new job but can opt-out of the scheme if they do not wish to contribute to it. They can also enrol voluntarily. Individuals can contribute either 4 percent or 8 percent of their pay, and since “1 July 2008 compulsory employer contributions of 1 percent rising to 4 percent of employee’s gross pay in 2011 ... apply.” Originally the scheme featured minimal government subsidies—“a flat $1,000 ‘sweetener’, and an annual fees subsidy of $40”—but a tax exemption was introduced for employer contributions to the scheme and in Budget 2007 the Government added matching tax credits of up to $20 per week for each dollar contributed by individuals. KiwiSaver has been in effect since 1 July 2007.

The incentives and subsidies are outcomes-focused, designed to enhance the scheme’s objectives of encouraging “a long-term saving habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement.”

But do they target those in need? The IRD's
initial evaluation of KiwiSaver found that those who had accessed the subsidies by joining the scheme in its first six months “seem to have higher incomes than non-members,” and that this was even more pronounced among those who had joined the scheme voluntarily than among those who were members by virtue of automatic enrolment and failure to opt-out. However, the IRD believe that over time it is “possible that the income levels between members and non-members will converge.”

A University of Waikato NZIER study reached a different conclusion. It stated that “The impact of KiwiSaver incentives in raising income inequality is ... likely to be an enduring feature of their design, rather than simply a transitory byproduct that disappears once membership becomes more universal.” The research conducted by the study’s authors found “that KiwiSaver members are older than non-members, are less likely to be Maori or Pacific Islanders but more likely to be male, to hold a degree or higher qualification, and to have higher incomes.”

These sources both suggest that, initially at least, KiwiSaver members are more likely to be those who were already in a good position to save, without needing government assistance to do so. This conclusion is reinforced by a further University of Waikato NZIER study, which concluded that “the evidence reported here confirms findings from overseas ... that tax incentives encourage people to shift existing saving to the tax-preferred vehicles, with little change in overall saving but large costs to the taxpayer.” It found “that out of every dollar of KiwiSaver balances, only 9–19 cents are ‘new’ saving. The rest is either reshuffling amongst existing saving and debt by KiwiSaver members, or else taxpayer and employer transfers which decrease national saving elsewhere.”

These figures suggest that the incentives are likely to be a relatively unsuccessful and highly expensive way of encouraging retirement saving by those who were not saving before. While a limitation of freedom through taxation can be justified to prevent damage to the common good, these studies suggest that the KiwiSaver incentives may not offer much protection to those exposed to the threat of inadequate retirement income. Of course, as the IRD notes, it is early days for KiwiSaver. However, it is worth bearing in mind that the hole in the government’s revenue caused by the incentives and subsidies represents an opportunity cost. This money could have been used in other ways that would allow taxpayers to save for their retirement without the risks associated with attempting to structure people’s choices, for example by cutting personal income taxes to leave more in the hand to save. As noted in the discussion of the tax mix (below), cutting taxes on income, including taxes on income from savings, could be achieved by altering the tax mix to rely more on GST. This would also have the advantage that, as a consumption tax, GST does not tax investment income. If there is a need to encourage saving, this may be a better way to achieve it.

Charitable tax incentives

On 1 April 2008, tax incentives for charitable giving were significantly increased. Up until this point, donations to charities by individuals were eligible for an annual rebate of one third of the total given, up to a maximum rebate of $630 on donations totalling $1,890 or more. Once the maximum amount of $1,890 was given, further donations attracted no
extra rebate. After 1 April 2008, the limit of $1,890 was removed so that all charitable donations up to the level of the donor’s annual taxable income are eligible for a tax credit of one third of the amount given. For example, someone who gives $6,000 to charity is now able to claim a tax credit of $2,000, as long as their taxable income is at least $6,000.

The changes followed the production of a government discussion document, “Tax Incentives for Giving to Charities and other Non-profit Organisations,” as part of the development of “a new tax rebate regime for charities.” Its aim was “to encourage more New Zealanders to give of their money, skills and time, and to reinforce the concept of giving, to charities and to other non-profit organisations.” Interestingly, the discussion document noted that there is no conclusive evidence showing that tax incentives are effective at encouraging charitable giving across the board, though they may “reinforce an existing inclination to give ... and can lead to larger donations being made, and ... high-income people tend to be more responsive to tax incentives.” However, “[t]he general view is that tax incentives introduced in isolation are unlikely to change philanthropic behaviour or attitudes significantly. Rather, a range of initiatives is likely to be required, including better education ... as well as other promotional strategies.”

The discussion document also referred to research commissioned by Philanthropy New Zealand on motivations for giving. According to this research, the most frequent reasons why people give to charities fall into four main categories: a liking for the cause or object of the charity; concern for the disadvantaged in society; the integrity of the charity in question; and the donor’s level of income. The research also found a link between income and the amount given, meaning that “the higher a person’s personal income, the greater the amount their donations in the past year are likely to have been.” In a subsequent report prepared to assist submissions on the discussion document, Philanthropy New Zealand commented that “It was significant that the subject of tax rebates was not referred to at all as either a reason to give or not to give,” though the potential effect of tax incentives does not appear to have been put to the survey respondents.

It is therefore uncertain what difference the changes to the charitable tax regime will make. The amount given may increase as “high-income people” respond to the incentives, but it is less obvious that the changes will meet the aim of “encourag[ing] more New Zealanders to give,” given the findings cited by the IRD suggesting that the impact of incentives tends to be limited to existing givers. No doubt the effectiveness of the changes will be evaluated in due course, and if they are successful they will help to strengthen organisations that play a crucial role in society. This may be sufficient to justify the limitation of freedom involved in the attempt to guide people towards giving, though an alternative measure with the same effect might be to reduce taxes, given the relationship between level of income and charitable giving.

However, the conclusion that the limitation is justified may be affected by some strings attached to the measures. The discussion document refers to charities receiving “public monies through private donations or grants,” and apparently considers that charitable tax incentives constitute government “spending on assistance to charities.” This is consistent with comments in an earlier discussion document, “Tax and Charities,” to the effect that the charitable tax rebate amounts to a government subsidy of charities or “a form of public funding.” This underpinned some “concerns about using the tax system to support charities,” which were essentially that the government did not have sufficient control over the use of this “subsidy.” In addition, one reason that was given in the later discussion document for encouraging donations to charities is the fact that “Charities and other non-profit organisations help governments to further their social objectives.”

These comments suggest that tax incentives to encourage generosity will be accompanied by increasing government oversight and regulation of charities. This has already happened through “the establishment of the Charities Commission, which was set up to administer a new registration, reporting and monitoring framework for charities.” The incentives thus risk undermining the principle of subsidiarity, as the accompanying government oversight extends its reach into the community organisations they support. As charities become more and more dependent on this “public funding,” the risks increase.

Whether subsidiarity is in fact undermined may depend on how the Commission exercises its responsibilities. However, the issue could have been avoided altogether if the Government had simply trusted charities to use their resources well, and
trusted the public to be able to tell genuine charities from shams.

Finally, it should be noted that increasing the size of the tax incentive effectively reduces the sacrifice that individual givers make when they give.\(^82\) Altruism, though, is usually understood as involving sacrifice, and the less of it that is involved, the less altruistic a charitable donor is being. As tax incentives increase, the situation more closely resembles one where “givers” are effectively directing public money, collected through taxation, to the charity of their choice at reduced cost to themselves. The current rebate limits may mean this is a minor concern, but the point should suggest caution about further increases. It would be unfortunate if incentives that were meant to encourage sacrifice, unselfishness and altruism were rendered ineffective in this way.

“Sin taxes”

Another way the tax system attempts to limit freedom, short of outright prohibition, is by imposing so-called “sin taxes.” These are taxes on what might be regarded as vices—alcohol and cigarettes, for example—intended to deter their consumption. Is the limitation of freedom justified? In other words, is it necessary to meet a threat to the common good that cannot be met by non-governmental action?

The McLeod Review considered this issue, and distinguished between the “efficient pricing” approach to sin taxes, and the “health policy” approach. The “efficient pricing” approach is intended to ensure that all the “external” costs associated with a product or activity—such as public health expenditure on smoking-related diseases—are included in the price of the product or activity. By contrast, the “health policy” approach aims to deter unhealthy products or activities by increasing their price, with no regard for such externalities.\(^83\) The Review concluded that the health policy approach was not “a robust tax policy framework,” apparently because deterrent taxes would be arbitrary.\(^84\) In its Issues Paper, the Review also queried the selective nature of the taxes on alcohol and tobacco, when “other types of risky behaviour” are not taxed. Importantly, the Review believed that “Decisions to smoke, drink, gamble or drive all involve the acceptance of well publicised risks. In other spheres, people are left to make their own choices about a variety of potentially hazardous activities without undue intervention by the state.”\(^85\)

The Review also found that the “efficient pricing” approach was hard to support in practice, citing “The large discrepancy between estimates of tobacco-related health costs (estimates at about $225 million per annum) and revenue from tobacco excise (about $950 million in 1999/2000 after GST adjustment).”\(^86\) It also referred to “savings in other areas of social spending” which are not usually taken into account and which lessen the case for price increases. Specifically, smokers die younger and collect less government superannuation than their non-smoking peers, offsetting the increased public health spending they incur.\(^87\) Finally, the Review considered that where externalities did exist, tax was not necessarily “the most appropriate form of intervention.” Targeted measures—such as drink-driving advertising campaigns—were thought to be a more appropriate and effective way of dealing with the harm that the externalities represented.\(^88\)

The Review’s analysis leaves the case for sin taxes looking rather thin. However, there may be greater scope for the health policy approach than they allowed. Alcohol abuse, for example, does great damage to our social fabric, and decreasing the cost of alcohol to those who misuse it is unlikely to improve matters. Nevertheless, the point about targeted measures is important. There may be more effective ways of tackling the problem than taxation. Requiring cigarette packets to feature gruesome pictures of damaged organs, sourced from smokers’ cadavers, is likely to bring home the risks of smoking more effectively and directly than an increase in tobacco excise. Advertising campaigns have very successfully influenced public attitudes to drink driving. Measures such as these represent less of a limitation of freedom than sin taxes as they require less direct government intervention in people’s choices and also require the development and use of personal responsibility. They also seem more likely to work in the long term, as they effect cultural change rather than depending on changing economic circumstances.

Conclusion on tax incentives

The increasing use of tax incentives seems to reflect an increasing desire for government to direct people to purposes it believes are desirable and to rearrange outcomes. Of course, incentives are not always successful. All the incentives in the world will not
induce people to save if they do not have any money to save in the first place, and in any case people are not “rational calculators,” but are “guided by morals, affected by duties and influenced, but not controlled, by incentives.”

None of this is to say that incentives are never permissible. Particular incentives may be a reasonable response to a particular threat to the common good. But even where this is the case, it is important that the use of incentives is consistent with the principle of subsidiarity. Not every threat requires a government response, and just because it would be good for people to act in a certain way does not mean the government should try to direct them accordingly. Government responses may erode community responses. For example, public funding of charities may displace private funding. Government intervention in response to a particular threat may also damage the common good in other ways, for example by encouraging sectionalism. As the OECD saw, tax incentives “generate intensive lobbying from special interest groups pressing for tax concessions for their particular sector. In this context, it would be useful to level the playing field by removing existing taxation preferences.” Incentives often create unintended negative consequences, such as the “poverty traps” of Working for Families and the probability that KiwiSaver incentives are mostly benefitting those who were already in a position to save. Nor are they costless. Incentives reduce the tax base, putting increasing pressure on other areas to raise the revenue required to fund them and all the other functions of government. They also represent an opportunity cost, as the sums spent on them could have been allocated in other ways, for example to tax cuts.

The OECD was dubious about the use of such incentives:

Non-neutral tax policies that are unevenly applied to various activities encourage New Zealanders to devote resources to less-taxed activities, rather than to those that generate the greatest economic returns. This can induce a sectoral misallocation, as tax preference is given to certain types of investments. Another risk is that, because targeting requires more information than is normally available, incentives are often given too widely by subsidising activity that would take place anyway. Targeted measures also increase the compliance and administration costs.

If incentives are employed in response to a threat to the common good, their duration should be limited to the duration of the threat, in accordance with the principle of subsidiarity. For example, consideration should be given to whether tax incentives to encourage a culture of saving or charitable giving should be withdrawn over time. It might be argued that if they are withdrawn, the behaviour they promote will cease. If so, it suggests that that behaviour was simply a response to a stimulus, and did not amount to a culture, meaning that the incentives were not able to achieve what they were intended to.

Finally, the use of incentives to structure choices and shape behaviour amounts to what de Tocqueville called “soft despotism,” where “the will of man is not shattered, but softened, bent, and guided. Men are seldom forced to act, but they are constantly restrained from acting.” The implications for freedom, responsibility and a meaningful life are concerning, as de Tocqueville saw:

What good is it to me, after all, if there is an authority always busy to see the tranquil enjoyment of my pleasures and going ahead to brush all dangers from my path without giving me even the trouble to think about it, if that authority, which protects me from the smallest thorns on my journey, is also the absolute master of my liberty and life? If it monopolizes all activity and life to such an extent that all around it must languish when it languishes, sleep when it sleeps, and perish if it dies.

GOODS AND SERVICES TAX (GST)

GST has been in the headlines recently, as changes to the tax have been suggested to help households weather the impact of an economic downturn. For example, earlier this year the Residents Action Movement called for GST to be removed from food, saying this was “the tax cut of most benefit to people struggling to pay the bills. Overnight it would slash every family’s food costs by 12.5%.” The usual suggestion is that GST should be removed from “basic” foods to make it easier for struggling families to afford them. Although this is a recent issue, debate about the fairness of GST has been around for longer.

GST applies to “supplies of goods and services
consumed in New Zealand.” The tax is broadly based, with few exemptions.95 It is therefore a good example of a tax that treats people equally; most purchases of goods and services will attract GST, regardless of the income, family status or savings habits of the purchaser.

However, it is argued by some that GST “impacts disproportionately on low-income people.”96 The argument often made is that GST is regressive. Regression is the opposite of progression, so a regressive tax policy is one where someone on a low income pays a higher proportion of their overall income in tax than someone on a higher income. The complaint is motivated by the same concerns about outcomes that motivate advocates of progressive taxation.

The McLeod Review noted this issue, but considered that:97

> the regressivity of GST is often overstated. We note in this context research by the Treasury that found GST to be roughly proportional to income for the 80 percent of households in the middle of the income distribution. The Treasury study concluded that introducing multiple GST rates or exemptions for commodities such as food and domestic fuel would have little effect on the overall incidence of GST, but would undermine neutrality and increase compliance costs. A similar conclusion was reached in a later independent study.

It is also argued that “By and large, people consume over their lifetimes what they earn …. Goods and services tax is therefore best seen as a roughly proportional tax.”98

All of this suggests that the concern about GST and regression may be more theoretical than real. Even if there is a real cause for concern, the issue again is whether an outcomes focus (concerns about regression) should be prioritised over treating people equally (applying the same rate of GST to everyone and every type of good and service). It would need to be shown that GST impacts adversely on those in real need to an extent that justifies departing from norms of equal treatment, and that something could practically be changed about GST that would allow this concern for outcomes to be targeted to those in need. Demands for certain “basic” foods to be GST-exempt are not targeted to need. The rich, as well as the poor, buy staples.

As the McLeod Review noted:99

> Because exemptions or lower GST rates for particular goods and services cannot be targeted just at lower income households, they are generally acknowledged as inefficient (and often ineffective) methods of achieving distributional objectives. We are sympathetic with this view, which implies that distributional concerns are best addressed through expenditure programmes or the income tax system.

THE TAX BASE AND THE TAX MIX

The choice of the tax base has implications for freedom. The largest single source of core Crown revenue comes from taxes on personal income, which make up $27.2 billion, or 44 percent, of core Crown revenue of $61.9 billion. GST is the next largest individual contributor, collecting $11.9 billion, or 19 percent of revenue. The balance largely comes from taxes on other forms of income, such as investment income and corporate income and profits, and “other indirect taxes.”100 So the “tax mix”—the relative weighting of each tax base—favours income, though consumption does make up a reasonable proportion of the total.

The central implication for freedom is that taxing income requires an in-depth assessment of each taxpayer’s financial affairs. A “direct tax” like this therefore stands in contrast to an “indirect tax” like GST, which is not assessed on an individualised basis and does not require taxpayers to open up their financial affairs for assessment. A further implication for freedom is that “GST is more neutral” than income tax, because it is more broadly based and applies at the same fairly low rate to almost all goods and services. This means that it “is less likely to alter economic decisions than the less comprehensive income tax.”101 Because the opportunities to avoid paying GST are few, decisions are not likely to be based on whether they will incur GST or not. By contrast, because not every financial gain is a form of income, decisions are more likely to be influenced by whether they will incur income tax liability, meaning that some courses of action that might otherwise be chosen will not be pursued because they will be subject to income tax, and some others will be pursued because they will not be taxed.

Relying more heavily on revenue from personal income tax also results in personal income tax rates being higher than other rates. For example, the top
rate of personal income tax is 39 percent, while companies' income is taxed at 30 percent. These direct taxes in turn outweigh indirect taxes like GST, which applies at 12.5 percent. The overall effect is to encourage tax planning and tax avoidance. It appears that many taxpayers have altered their affairs to take advantage of the lower company and trust tax rates—for example, the rate of growth of corporate tax revenue between 2002 and 2007 was two and a half times greater than the rate of economic growth—and "between 1998 and 2003 the proportion of people reporting salaries of exactly $60,000 [the threshold for the top personal tax rate of 39 percent at that time] rose from 0.45% to 4%."102 As avoidance becomes more prevalent, there is increasing pressure to keep tax rates up to maintain the required level of revenue, which in turn provides greater encouragement for avoidance.

The danger is that the degree of reliance on income tax will encourage less productive, but tax-advantaged, forms of activity than would otherwise be engaged in. One way to deal with these concerns about the way the tax mix alters behaviour is to adjust it so that it has a greater consumption component. In other words, income taxes could be reduced and GST could be increased. The McLeod Review considered that "any overall increase in tax should be implemented through GST. By contrast, any reduction in tax should be focused on income tax."103 Of course, any level of income tax will require assessment of a taxpayer's financial affairs, but the lower the income tax is, the less likely it is to affect economic decisions. It would also have the advantage of reducing the penalty on productive activity that an income tax creates. It should be noted that this penalty applies to saving and investment, as returns from these activities are taxed as a form of income. Taxing income more heavily than consumption "encourage[s] consuming today rather than saving to consume in the future. Shifting the tax mix to place greater emphasis upon taxation consumption would encourage people to save rather than consume,"104 an issue that was raised in relation to the KiwiSaver incentives.

Some will object to this change to the tax mix on the grounds that it will be regressive, that is, it will require those of lesser means to pay a greater proportion of their income in tax than those of greater means. As was noted in the discussion of GST, the McLeod Review considered these concerns are "often overstated."105

Calls to lower GST, or to remove it from certain items, should therefore be resisted. Such calls are sometimes motivated by a desire to lower the tax burden, as we noted earlier. Others call for the removal of GST on "nutritious basics" to encourage families to eat more healthily.106 However, if the tax burden is too high and families are unable to afford to buy healthy items of food, a better solution would be to lower taxes so that they have more income available to purchase those items. If, however, they do have an adequate income to buy healthy food, then trying to change their choices through the tax system raises problematic incentive issues. Ultimately a better solution to bad choices is for people to exercise more responsibility in their decisions and, where those choices are due to lack of information about things such as which foods are actually healthy, for information to be provided so that people are able to make informed decisions.

**WHAT TAX IS SPENT ON**

Government spends the revenue it collects in a variety of ways. Some of its spending is on services and functions that are unquestionably core to government, such as the maintenance and provision of a police force and a judiciary to preserve law and order. However, spending is also designed to achieve a range of social policy objectives, such as boosting people's retirement income by contributing to individuals' KiwiSaver accounts and encouraging people to work through transfers targeted to those in paid employment under Working for Families, which is designed "to ensure that work [is] more financially attractive relative to non-work."107

Whether or not taxpayers use the services government provides or agree with the policy objectives, they are forced to fund them through their taxes. The imposition of taxes therefore amounts to "control of [their] environment or circumstances ... by another" that forces them "to act not according to a coherent plan of [their] own but to serve the ends of another."108 This, of course, was Hayek's definition of coercion, and it illustrates that the collection of taxes is a limitation of freedom.

As this discussion paper has reiterated, limitations on freedom are not necessarily bad. Instead, some limitations are essential to enable people to live together in society. In particular, co-existing with our
fellow citizens requires the existence of government, which has a proper part to play in protecting the common good of society. The limitations on freedom involved in paying taxes that fund government to do what it should are unquestionably justified, whether or not individual taxpayers want to pay them. However, taxes that fund activities and objectives that are outside government’s core role are not justified as limitations on freedom. The key question, therefore, is whether activities necessary to achieve aims such as the social policy objectives mentioned above are within the proper role of government. That is, are they necessary to protect society’s common good from the threat of harm and are they consistent with respect for society’s custom and tradition and the principle of subsidiarity?

It is beyond the scope of this discussion paper to analyse every government policy and activity to determine whether it is within government’s proper role so that the taxes that fund it are justified limitations of freedom. The paper therefore considers an example, Working for Families, which was discussed earlier. Is the attempt to provide extra income to families with children necessary to protect New Zealand’s common good from harm?

The earlier discussion of Working for Families revealed that it suffers from a number of drawbacks. Despite the fact that it has obviously had some degree of impact on child poverty rates, it is not well targeted to need and it creates “poverty traps” and “marriage penalties.” It therefore discourages people from valuable and productive activities that would allow them to support themselves.

Targeted tax policies such as Working for Families also encourage sectionalism. That is, they encourage groups in society—in this case, families with children—to promote their own interests and seek benefits and subsidies that favour them to the exclusion of other groups. Those other groups are then likely to lobby for their own special tax breaks, gradually splintering not only the tax system, but society as well. This undermines the common good, “because it is difficult for people to conceive of the common good when they think of the needs of their own identity group first.”109

Finally, Working for Families encourages people to become reliant on the government, and this dependence undermines their ability to hold the government to account, to act as the “independent eye of society.” People are not likely to bite the hand that feeds them, and they are less likely to challenge or reject a government that provides financial assistance to them, especially once they come to rely on that assistance as a regular part of their income. Reliance on the government reduces the need for the community to support its members, weakening the bonds between them.

The Working for Families package as a whole therefore does not appear to protect the common good from harm. The effects on child poverty are offset by its discouragement of productive work and encouragement to families to become reliant on government assistance. If the programme were tightly targeted to poverty that would lessen the objection, but as has been discussed that is not the case. Nor does the programme appear consistent with subsidiarity. Encouraging economic growth would give individuals and communities the opportunity to generate wealth that would raise incomes and living standards, meeting problems of poverty and income adequacy by themselves. Rather than do this by cutting taxes or directing its spending to relevant measures, the government has chosen to step in and rearrange the distribution of resources in society. There is no indication that Working for Families is time-limited in any way that would be consistent with the principle of subsidiarity. As a result, the final conclusion must be that the taxes collected to fund Working for Families as a whole represent an unjustified limitation of freedom.

THE LEVEL OF TAXATION

The level of taxation also has implications for freedom. The more tax that is collected, the more taxpayers are vulnerable to being “forced to act not according to a coherent plan of [their] own but to serve the ends of another.”110 This is because as taxpayers are deprived of a larger and larger share of income, someone who can replace some of that income gains the ability to direct the taxpayer’s behaviour by attaching conditions to the replacement income. For example, the more tax that families pay, the more likely they are to require government assistance to survive financially. Such assistance invariably comes with strings attached which allow the giver—that is, the government—to direct the behaviour of the recipient to achieve desired policy goals. Working for Families is intended to boost the incomes of families with children, but it is also intended to affect the
employment behaviour of parents, because it comes with the condition that family members must spend a certain number of hours per week in paid employment to qualify for the In-Work Tax Credit component of the programme.111

Whether incentivising work is a worthy goal is not the issue. Rather, the issue is that increasing levels of taxation can increase people’s responsiveness to incentive schemes, allowing their behaviour to be directed more easily. Families might be freer to make their own decisions about work if taxes were lower in the first place, so that they did not need financial assistance from the government. This would imply greater respect for the principle of subsidiarity, as it would allow families to maintain their responsibility for their sphere of life without government intervention.

This is becoming an increasing issue because in recent years government has collected increasing amounts of tax and spent increasing sums of money. “Core Crown revenue” is expected to increase from $58 billion in 2007 “to over $69 billion by 2012.” While tax revenue will decrease as a result of cuts to personal and company income taxes:112

   total Crown revenue … is still expected to be about 43 to 45 percent of GDP over the next five years. If government revenue is on the rise, then core Crown expenses (the government’s day-to-day expenditure excluding capital spending) are forecast to grow even faster. According to the Treasury, this is because of expenses brought about by new initiatives introduced in recent Budgets, such as allowing progressively more money for KiwiSaver … A paper released by the Centre for Independent Studies in 2007 also determined that core Crown expenses were $20 billion more than in 2000. This was an increase of 32 percent in real terms. Between 2007 and 2012, the Treasury also forecasts that core Crown expenses are likely to increase from $54 billion to $69.9 billion, although as a proportion of GDP the spending remains constant at about 33 percent. Among this spending, benefits alone are expected to cost $4.4 billion, with about $2 billion of that allocated to adjusting benefits to the cost of living, but also adjustments to the Working for Families tax credits.

KiwiSaver is expected to cost just over $1.5 billion by 2011-12.113

As was discussed earlier, the annual Index of Economic Freedom reveals that high levels of spending and hence tax undermine economic freedom and hence prosperity. Davidson finds that “High taxes can also undermine entrepreneurial behaviour.” He cites one study that shows “convincing evidence that tax rates have important effects on entrepreneurial entry and survival,”114 and others that demonstrate that “as the entrepreneur’s tax rate increases, so their probability of employing workers declines and, to the extent they do employ additional labour, decreases the growth rate in wages. High rates of taxation on ‘the rich’ can therefore lead to less employment and lower wages over time for ‘the poor’ who then become relatively even poorer.”115

This is contrary to the government’s responsibility to provide an appropriate environment for an entrepreneurial culture.116 It reduces individuals’ and communities’ ability to provide for themselves, increasing their reliance on government provision and therefore reducing their ability to act independently of government.

ALTERNATIVE POLICY DIRECTIONS

The focus on outcomes and the increasing reliance on tax mechanisms explicitly designed to alter people’s decisions appear to represent an increasing desire for the government to direct people to act in certain ways and to achieve certain general objectives for society, like a reduction in material inequality. Concern for outcomes is justified as a compassionate response to genuine need, but this is different in nature to the concern to direct broader social outcomes and the attempt to define this as a principle of justice. Similarly, the general use of incentives is not necessarily to be avoided, but particular incentives must be assessed according to whether they are consistent with the government’s role and the proper limits of freedom—that is, are they necessary and effective to protect the common good and do they do so in a way that respects proper custom and tradition and the principle of subsidiarity? For example, the KiwiSaver tax incentives may not be effective to achieve their goal of promoting a culture of retirement saving and do not appear to be well targeted to need, suggesting that they may actually undermine the common good. Charitable tax incentives may be more effective, though the evidence appears to be mixed, and if they are they will help to strengthen organisations that have a vital role in upholding the common good.
This discussion paper has offered a critique of some existing tax policies, based on the preceding considerations of justice and freedom. The purpose of this paper is not to propose alternative policies. That will be the topic of a later paper in the series. However, the discussion in this paper suggests some alternative policy directions worthy of further investigation that could inform changes to the existing system. They might include:

a. lower taxes that allow individuals and families to keep more of what they have earned;

b. flatter taxes that treat people more equally and reduce the possibility of the tyranny of the majority;

c. altering the tax mix to prefer consumption taxes to a greater degree and income taxes to a lesser degree than at present;

d. strict assessment of tax policies to see whether they are actually necessary and effective to protect the common good from harm;

e. fewer measures designed to direct people’s behaviour and the devolution of greater responsibility to individuals and communities for their well-being and the well-being of those around them;

f. the adoption of an absolute measure of poverty, rather than a relative one, in order to better identify those in genuine need.

Policy changes of this sort are likely to strike a better balance between justice, freedom and compassion. Crucially, a re-balanced tax system will require us to take greater responsibility for our own well-being and for the well-being of those around us. This devolution and assumption of personal responsibility and concern for others, to the point of personal sacrifice, will require cultural change. It will, however, allow justice, freedom and compassion to flourish better than at present, and as a result will strengthen the social fabric and protect the common good.

ENDNOTES

4 See W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, (Chicago and London: Chicago University Press, 1978), 38, where this point is made in relation to the benefit principle.
8 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 60–61.
11 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 46.
14 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 1.
16 R. Nozick, Anarchy, State, and Utopia, 163.
18 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 21.
19 S. Davidson, “Cut Taxes to Raise More Revenue,” 44.
20 W. Blum and H. Kalven, The Uneasy Case for Progressive Taxation, 25.
Is it Just Tax? The shaping of our society

24 S. Thomas, "Governing for the Good: What does it really mean?" (Auckland: Maxim Institute, 2008), 71-73.
41 G. Dwyer, "Dissecting the Working for Families Package," 47.
43 G. Dwyer, "Dissecting the Working for Families Package," 42.
54 G. Dwyer, “Dissecting the Working for Families Package,” 40.
60 J. Gibson, C. Hector and T. Le, “The Distributional Impact of KiwiSaver Incentives,” 8.
61 J. Gibson and T. Le, “How Much New Saving Will KiwiSaver Produce?” (Hamilton: University of Waikato, 2008), 17, internal citations omitted.
64 S. St John, “KiwiSaver and the Tax Treatment of Retirement Saving in NZ,” 251.
65 S. St John, “KiwiSaver and the Tax Treatment of Retirement Saving in NZ,” 258, internal citations omitted.
66 S. St John, “KiwiSaver and the Tax Treatment of Retirement Saving in NZ,” 263, internal citations omitted.
70 M. Cullen and P. Dunne, "Tax Incentives for Giving to Charities and other Non-profit Organisations," 3–4. In an earlier discussion document, a slightly different view was taken: “empirical studies suggest that subsidies to donors encourage charitable giving ...” M. Cullen, P. Swain and J. Wright, “Tax and Charities,” (Wellington: Inland Revenue Department, 2001), 7. Presumably the IRD changed its mind about the weight of the evidence between discussion
documents.


76. M. Cullen, P. Swain and J. Wright, “Tax and Charities.”


93. Cited in S. Gregg, On Ordered Liberty, 92.


110. S. Thomas, “Governing for the Good: What does it really mean?” 5-6, internal citations omitted.


SECTION 7
Summary and Conclusion

This discussion paper began with the bigger picture provided by the concept of the common good and questions about what our country should look like. It proposed that current issues about tax policy, whether they concern justice, freedom or compassion, should be seen in this context. It then proceeded to consider how these issues should be understood and how they should be reconciled when they come into conflict. Finally, it asked what these concepts imply for particular tax policies.

The discussion of justice revealed that many of the current themes in the debate about fair tax concern the way that taxation will achieve certain outcomes. These outcomes include greater equality in incomes or wealth, redistribution of income to certain groups like families with children, and allocating a disproportionately greater share of the tax burden to those with greater ability to pay. However, this paper has suggested that justice is not actually consistent with this focus on outcomes. Instead, it has argued that the touchstone for justice is whether correct processes are followed, that is, whether people are treated equally and in a way that respects their legitimate ownership of their income and other property. This means that justice is not concerned with the distribution of resources or whether some have more than others.

Nevertheless, there will be grounds to be concerned with people's outcomes when those outcomes represent a risk of harm to the common good. Genuine hardship and poverty that prevent people from pursuing and experiencing the common good give rise to a moral obligation of compassion that requires and justifies action to meet the needs that are involved. This action is not automatically government's responsibility. Instead, the principle of subsidiarity requires consideration of whether individuals and communities are better placed to respond to the need in question. If they are not, government may take action, but its policies and programmes must be tailored to respond to the need that creates the threat in the first place. This will mean considering issues such as the long-term consequences of government action, whether tax or other government policy will actually be effective to meet the need, and the role that others outside the government can play in meeting the need and fulfilling the moral obligation. It means that redistribution for redistribution’s sake, in an attempt to achieve some scheme of resource distribution unconnected to identifiable need, is not justified on the grounds of justice or of compassion.

Issues of freedom as well as of justice arise when tax policies attempt to pursue particular outcomes. This is because the focus on outcomes requires ongoing government oversight and intervention to ensure that the results of people's interactions conform to the desired outcome. Taxation also brings freedom to the fore in other ways. For example, paying taxes is a compulsory exercise, the use of progressive taxation creates the possibility of the tyranny of the majority, and there has been an increasing trend towards using the tax system to direct people's behaviour to certain purposes that have been identified as desirable.

This paper has argued that freedom should properly be understood as the absence of coercion. It also noted that freedom must be subject to limits to maintain an ordered society, and that these limits can be defined by a modified harm principle, employing the notion of harm to the common good. As a result, taxation to fund government in its proper role is a justifiable limit on freedom, as government's role is to protect the common good.
from harm. However, it is important that individuals use their freedom responsibly, to avoid the need for government to intervene and limit it for them. When government funds policies that are neither necessary nor effective to protect the common good from harm, the requirement to pay the taxes that provide those funds ceases to be a justified limitation and instead becomes unjustified coercion.

When applying this understanding of justice, compassion and freedom to particular tax policies, some common themes emerge. Progressive taxation is problematic on grounds of justice and of freedom, as it prioritises outcomes like greater income equality over treating everyone equally. It also allows a majority to require a minority to bear a tax burden that the majority does not have to bear, creating the possibility of unequal limitations of freedom. The recent changes increasing the progression of the personal income tax—the introduction of a new top rate of 39 percent in 1999 and rate cuts in 2008 to the bottom of the scale but not the top—increase the risks to justice and freedom. By contrast, consumption taxes like GST do not raise the same concerns about justice or freedom. As GST applies to almost all goods and services at the same rate, it treats people equally and does not distort economic decisions in the same way that current income taxes do.

The use of targeted tax incentives like those of Working for Families and KiwiSaver also treat people quite unequally. In the case of Working for Families, families with children are benefitted at the expense of other taxpayers, even when those families cannot be said to be suffering genuine hardship. The attempt to guide people to the good of work, though admirable, has the consequence of creating "poverty traps" through high EMTRs that discourage people from productive activity such as increased work output and greater responsibility leading to higher salaries. The generous KiwiSaver incentives are probably the reason that initial uptake of the scheme has been so high, but evidence to date suggests that many of those joining the scheme to access the subsidies are those who were saving already so that little in the way of new saving is being generated. Even if tax incentives can be designed in a way that makes them more effective at achieving their goals and less likely to undermine the common good, they are not justified unless they can be said to be a necessary response to an identifiable threat to the common good, a threat that cannot be met adequately except by government action.

Finally, high taxes, and highly progressive taxes, may stifle productive activity and particularly entrepreneurial activity. This is important because such activity allows people to provide for themselves and to remain independent of government assistance, which in turn protects freedom by reducing the potential for dependence on the state.

The overall picture is one of the tax system increasing limitations on justice and on freedom. The introduction and augmentation of the Working for Families and KiwiSaver tax credits, the increase in the level of taxation and in the progression of the personal income tax, and government oversight of the way "subsidies" to charities are used all envisage a larger role for government in society and in shaping people's choices and outcomes. These policies are often justified on the basis of compassion and need—for example, Working for Families is supposed to ensure "income adequacy"—but the policies themselves are not always well-targeted to need. Compassion and the need to protect the common good may provide grounds to support some of these policies, or elements of them. For example, charitable tax incentives may bolster civil society if they prove to be effective, and government transfers to families with children may be justified where those families are suffering real hardship. However, the overall picture is concerning, and it is worth asking whether the alternative policy directions identified in the preceding section might do a better job of providing for people while respecting justice and freedom.
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