Outline of evidence submitted to the Tax Commission on 19 November 1996

Evidence on taxation

Formal evidence has not been given on taxation in the past. Reluctance to do so stems from the fact that suggestions are seldom, if ever, implemented in the form in which they are proposed. Sound suggestions are adapted, very often becoming the antithesis of what the proposer had in mind. New single-tax proposals inevitably become additional taxes. Some examples are:

- Professor Friedrich von Hayek, the great free market economist, suggested to Finance Minister Owen Horwood on a visit to South Africa in 1978, that income tax be replaced by sales tax at a permanently low rate in the order of 4%. As inflation increased total tax would increase so it would never be necessary to adjust the rate. Regrettably, we got sales tax *as an extra tax. I*t increased over time to 14% and then became the more intrusive VAT. Professor Hayek would turn in his grave if he knew the result of his well-intentioned and economically sound proposal.
- Professor Milton Friedman, another free market economist, working for the US Treasury during the second World War was appalled when higher taxes were proposed to fund the war. As an alternative, he proposed the PAYE system as a *temporary* war measure. The whole world is now stuck with the system and Professor Friedman regrets that he ever thought of it.
- A dedicated tax to fund roads was imposed on fuel. After some years the fund was appropriated for general expenditure. Now a new dedicated fund is being proposed. Taxpayers will be fortunate if the original funding method is restored without additional tax being levied.

Taxation and economic growth

The FMF has decided to ask for a hearing on taxation because of its concern over the state of the economy, the urgent necessity of creating conditions conducive to increased economic growth and the dire results of not absorbing the currently unemployed into the labour force. The FMF has specific views, backed up by research, on policies that will improve economic growth which include views on taxation.

Economic freedom and its consequences

A presentation will be given on *Economic Freedom of the World 1975-1995.*

Case against multitude of taxes and frequent changes

Government is inclined to give insufficient attention to the *effects on the taxpayer* of a multitude of taxes and frequent changes to the system of taxation. Matters that warrant special attention are:

Costs of compliance

Costs of compliance are not factored into the calculations of government on the mistaken assumption that those costs do not affect the total tax the fiscus will receive. This view does not take account of the *vital role played by entrepreneurship in an economy* and the importance of capital accumulation in the hands of entrepreneurs rather than in the hands of administrators, accountants and lawyer.

Interference with forward planning

Projects often take years to formulate and plan. When new taxes are suddenly introduced they impact on planning that has been going forward in the economy. Tax changes are therefore disruptive and damaging to economic growth.

Land tax

Land tax was first put forward by Henry George who believed that this should be the sole source of income of government and that there should be no further takings from citizens. George did not call it a tax but a rent as he saw government as the custodian of all land. Appropriation of the land rent (land being a finite resource) would supposedly ensure that land would be utilised optimally. Increasing evidence such as the state land rented to ranchers in the USA has shown that the belief was fallacious. As to the proposal that there should be a land tax in South Africa the following should be considered:

1. *Cost of valuations and collection of tax*

A tax on farm and other rural property in South Africa based on value would require the establishment of a huge valuation roll which would have to be regularly updated. Owners would have to be given the right to challenge valuations and the objections would have to be heard by valuation courts. Whilst there will be lots of work for valuers, members of the court, accountants and lawyers, it would be totally unproductive. Add to this the time lost by owners in dealing with the issue. A massive cost will be imposed on farmers and taxpayers for a very dubious return to the fiscus.

2. *Who will pay the farmers costs?*

If all farmers are to pay the tax, their costs will rise in unison and they will endeavour to recover this cost by increasing the price of their produce to the consumer. To the extent that recoverability of those costs is not limited by lower priced imports, they will succeed. This will mean that food costs will be increased by the taxes imposed, much of the cost being borne by the poorest members of society. This cannot be the intention.

3. *Will a tax on land have a "Georgist" effect?*

To the extent that the theory may have any validity (which has been challenged by eminent economists over many years) it certainly will not have the effect if it is just another of many taxes. Georgists argue strongly that land will only be used efficiently if land rent is the *sole source* of income for government. Not unexpectedly, current discussions have moved away from the pure Georgist theory to the idea of simply tacking on a land tax as yet another tax.

Conclusion

The FMF is of the view that all taxes have a negative effect on economic growth. Consequently, if taxes can be maintained at very low levels, higher economic growth will be achieved. The Tax Commission is in the unenviable position of not being able to question the expenditure side of the budget. Yet the reduction of consumption expenditure by government is probably the single most important action required in order to bring about higher economic growth in South Africa. We question whether the Commission would be justified in avoiding the responsibility of expressing their views on the level of consumption expenditure in this country relative to the successful economies of the world. It is surely not expected of the Commission that it should put forward proposals for increasing taxes without considering the consequences of such tax increases.