Volume One, Number Two. December, 1967

THE RHODESIAN JOURNAL of ECONOMICS

The Journal of the Rhodesian Economic Society

Volume One, Number Two. December, 1967

THE RHODESIAN JOURNAL of ECONOMICS

The Journal of the Rhodesian Economic Society

VOLUME ONE, NUMBER TWO DECEMBER 1967

THE RHODESIAN JOURNAL OF ECONOMICS

VALUE ADDED TAXATION[1]

M. RULE

We now face the possibility of a radical alteration—I hesitate to use so emotive a term as "reform"—in our country's tax system. We face the possible introduction of an entirely new tax, and one which may, I think, be regarded as foreign to the British fiscal system, of which our own is an offshoot.

This new tax, the tax on value added, will, if introduced, undoubtedly become a central element in the Government's armoury of devices for raising —or, if you prefer it, extorting—revenue from the Rhodesian public. It will replace, in part or in full, a number of other sources of revenue and redistribute the burden of taxation not only in legal form but also in its incidence upon individuals.

In stressing the significance of this new tax, I must, however, warn against regarding it, or its potential effects as revolutionary. Put briefly, it will, if introduced on the basis proposed by the recent Committee on the subject, increase indirect taxation by a net amount of £8,500,000 per annum. This will be accompanied by a decrease of some £7,600,000 in direct taxation, the balance of £900,000 being unapportioned. On the current year's estimates, this would represent a swing of something over 10% of revenue receipts from direct to indirect taxation, the value added tax in isolation then representing some 20% of total revenue receipts.

These figures give some indication of the importance of the change proposed, but also show that the new tax will not be the main foundation of the fiscal system. To me, they suggest, also, that the favourable or unfavourable effects of the tax on the economy are more likely to be, in general, marginal rather than fundamental in nature. I certainly do not see this new impost either as an economic panacea or, for that matter, as a serious threat to our future prosperity.

I enter this caveat mainly because some of the arguments already advanced for or against the tax have been couched in what I regard as rather extreme terms. Equally, and for the purposes of clarity, some of the points I shall later make will possibly be, in isolation, overstated.

1 Paper read to the Society in September 1967.

This will, I hope, not prove a serious defect for it is, in any event, not my purpose to attempt a comprehensive analysis of the possible effects, let alone the operation of the new tax. I hope, instead, for no more than to raise a limited number of points on the general economic results of the introduction of the tax—points which may suggest lines for further discussion and investigation.

As a final caveat, I do not propose to go into any detail in describing the tax itself. I think it sufficient to distinguish between turnover taxes, levied on the entire sales of taxable bodies, and the value added tax, levied only on income less purchases. The former class of tax, if levied at more than one level in the economy results in double, or repeated taxation of products—the tax-on-tax or cascade effect; the latter avoids it.

The only other point I think worth noting in defining the tax is that it may be levied on sales less non-capital purchases plus an allowance for the depreciation of capital equipment. It may also be levied—and this is what is proposed for Rhodesia—on sales, including sales of capital equipment, less purchases, including capital purchases. In this latter form—the consumption variant and allowing for the taxation of imports and the exemption of exports—its base is, in effect, private consumption expenditure, plus public current expenditure on goods and services.

Having thus most cursorily defined the new tax, I find it interesting to reflect that, two years ago or less, few in Rhodesia had any clear idea of its nature. In fact, I sometimes wonder how many of us even today have any clear concept of it. Let me hasten to explain that, in referring to "us", I do not mean my present audience, no doubt fully acquainted with all aspects of the tax—I mean the Rhodesian public and, specifically, the business community.

I make this remark because it has, over recent weeks, been borne forcefully upon me that a disturbingly high proportion of businessmen seem to have little idea of the form, let alone of the possible effects of the tax and, not unusually, that the strength of their opinions on the merits of the tax is inversely proportionate to their understanding of it.

This leads me to wonder whether we, in this country, are likely to repeat the Irish experience of 1963. That country then considered and introduced a turnover tax, whose birth pangs have been described in the following terms:—

"This unconventional publicity for a new tax prior to its introduction was an attempt to condition people to a major change in taxation and to allow time for its justification to be realised. Theoretically, this seemed to be the right

way of approaching the problem but, practically, the time-lag from its first official mention to its introduction and implementation allowed the forces of opposition to grow. The introduction of the tax came close to overthrowing the Government . . . "[2]

A Revolutionary Tax

The new tax, therefore, represents a measure foreign to established fiscal policy in Rhodesia and in the countries with which it shares common traditions; a measure of which most Rhodesians until recently knew little or nothing; a measure of whose nature and effects there is still much ignorance and more uncertainty; but a measure which, if adopted, would greatly change the Rhodesian fiscal horizon. Where, then, has the proposal for its adoption originated?

The simplest answer is in the Report of the Committee on Value Added Turnover Taxation published here a short time ago.[3] That Committee was, in turn, set up by the Minister of Finance a year ago to consider the pros and cons of the tax. But the true origin of the tax, and hence of its possible adoption in Rhodesia, must be sought in France.

That country was the first and is still the only major state to apply a value added tax. Denmark, I believe, has it; the state of Michigan uses it; and, it was recommended by Americans for use in Japan, but their advice was not acted upon.

On the other hand, Germany will follow France's example on the 1st January 1968 and the whole of the European Economic Community will, by the beginning of 1970, have adopted a value added tax applied under uniform principles, though not necessarily at uniform rates.

The French Experience

I lay some emphasis on the French origin of the tax mainly because this has, in some minds, undoubtedly given it an emotional aura not conducive to its logical and critical examination. Admirers of planning in a form less extreme than that practised in Communist countries find in France both the model and the proof of the desirability, even necessity, of this form of central direction and exhortation. For those already convinced in this respect, it is

2 M. J. MacCormac, "Turnover Taxes—The Irish Experience": Lloyds Bank Review, April, 1967.

3 Report of the Committee on Value Added Turnover Taxation C.S.R. 34–1967.

easy to see in France's value added tax another—and related—device whose merits are self-evident and whose adoption consequently and equally obviously desirable.

Sure enough, the report of our own Rhodesian Committee states:—

"The subsequent success of the French tax on "value added" in relation to re-equipment and exports may be attributed largely to the removal of its predecessors' disincentive effects in these fields." (para. 11).

This curiously worded passage assumes that the value added tax has had a success, whose nature and extent is unspecified, in its effects on capital formation and exports and that this success would have been denied France had that tax not replaced the earlier production and transaction taxes.

Apart from the fact that this view seems markedly to overstate the extent and speed of the French reforms and apart from the difficulty, common to all practical economics, of isolating the overall effects of a single measure there is, I suggest, no evidence that any successes secured by France in the fields of investment or exports have not been equalled or surpassed by other countries with other tax systems—including systems which, in their "cascade", or cumulative effects, were similar to that whose replacement in France allegedly had such favourable effects.

In much the same way as I am doubtful of a simple and unsubstantiated contention that the tax has proved good for France—and hence will be good for us—I see little merit in the argument that, because the tax is spreading through the EEC, it must be desirable and, hence, should be adopted here. I think it worth stressing that European countries have, generally, long relied on turnover and similar taxes for a substantial part of their revenue; that the value added tax is clearly preferable to a cascade type of turnover tax; that the replacement of the latter by the former—as the Community intends—is, in consequence, desirable; but that it does not follow that the introduction of the value added tax, other than as a substitute for a simple multi-stage turnover tax, has anything much to commend it. And we are not, in Rhodesia, faced with such a substitution.

This is, in fact, recognised by the Committee when it says:—

"It is pertinent to recall here that the success of VAT in France, in relation to modernisation and exports, stemmed in great measure from the disincentive effects of the taxes it replaced, and it is clear that to achieve success, where no particular disabilities already exist, the introduction of VAT would have to be accompanied by other fiscal reforms". (para. 35).

In brief, the tax succeeded in France mainly because it was better than the taxes it replaced. Yet our own present taxes impose no particular disabilities of the sort inherent in those former French taxes. If this is so, it is fair

to approach the case for introducing the French tax here with a measure of scepticism. May its transplantation to Rhodesia not prove as great a fiasco as the transplantation of that Gallic panacea, indicative planning, to Britain?

The Rhodesian Proposals

So much for the background. I must now turn to a rather more detailed examination of what may be in store for Rhodesians. It is in brief proposed, as a basis of discussion, that the difference between the cost of the purchases of goods, including capital goods, and services having in both cases already borne tax and the value of sales, including sales of capital goods, should be treated as value added and be subjected to tax at a flat or constant rate. It is further suggested—still more tentatively—that this rate may be 7½%; that the tax should be introduced over 4 years, and that it should be accompanied by the abolition of the sales tax, personal tax, supertax and undistributed profits tax, the reduction of income tax and various other lesser measures.

The proposals envisage that the value added tax should apply to all sellers of goods with a turnover of £5,000 per annum or more and to all providers of services whose annual turnover exceeds £1,000. This of course, creates a broad range of exemption from the tax—it would, obviously, exempt from its application most African farmers, and, I imagine, a large proportion of African traders.

Despite this exemption, however, it is clear that the system, as at present proposed, looks to a simpler, more general and more uniform tax structure than that of, say, France. In that country, for example, a turnover tax continues to exist as, for some enterprises, an alternative and, for others, a substitute for the value added tax; the rates at which the tax applies vary from 6.4% to 33.3%, with some goods enjoying total exemption.

This sort of discrimination in rates, even if socially justifiable, gives rise to quite obvious anomalies. One can, I suppose, appreciate the emotions which allow war memorials to share with basic perishable foodstuffs the privilege of total exemption. But why should honey be exempt and jam pay 6.4%? Why should at least some newspapers and periodicals be exempt, yet books pay 11.1%? Why are cine cameras, at 29.9%, clearly less of a luxury than radio sets at 33.3%?

The Problem of Exemptions

To give an example of the sort of complication to which this form of discrimination gives rise, I can, I think, do no better than to quote from

Clara K. Sullivan's book[4], "The Tax on Value Added". known to at least some of you as being, in its own blurb, "The first definitive treatment of the value added tax to appear in any languge"—its style often leaves some doubt of the language in which it is written.

I quote:—

"Newspapers and periodicals are exempt on their sales . . . provided that they conform with certain requirements, notably that of having a character of general interest in the diffusion of information, instruction, education and recreation. A similar exemption applies to publications of philanthropic organisations or those whose purpose is devoid of special interest and to periodicals published by organisations for family gardens". (Page 90).

Leaving on one side the fascinating possibilities of this sort of thing as a hunting ground for tax collectors, tax avoiders and their supporting accountants and lawyers, it is worth noting that one merit claimed for the value added tax is its neutrality, its avoidance of such artificial incentives as that to vertical integration inherent in the cascade tax. This merit is largely lost in France and as Sullivan puts it:—

"Such differential taxation not only distorts the competitive relationships among various industries and firms within an industry but also leads to changes in business methods not intended by the tax and, moreover, directs taxpayers efforts towards the nonproductive pursuit of tax avoidance". (Page 120).

As I have indicated, our version of the tax is at present intended to be uniform and reasonably general in its application. I personally doubt, however, whether our own, if actually introduced, will more closely approach the virgin purity of the present proposals than the less virtuous form of its French model.

It seems to me reasonably clear that many segments of the business community, and particularly those organised bodies which at their annual congresses raucously assert their claim to be the back-bone of the country —Rhodesia must, to coin a word, be one of the most multi-vertebrate of nations—will claim that they deserve special treatment as an interim measure. And I see little in our history to suggest that some special interests will not secure concessions—and that interim concessions will not become as permanent as anything else in the fiscal system.

I have thus far referred briefly to what I see as the background of this proposed tax and have suggested that it is unlikely to be as simple or, in economic terms, neutral as has been suggested. The most important question

4 Clara K. Sullivan "The Tax on Value Added".

is, however, why the introduction of the tax should, in Rhodesian conditions, be considered desirable.

The Case for the Tax in Rhodesia

The three points I have most often seen stressed in this respect are the roles of the value added tax as a promoter of efficiency, as an incentive to exports and as a tool of economic planning. Our own Rhodesian committee of enquiry has, in fact, laid much stress on at least the first two of these points.

On the question of efficiency, it said, for example:—

> " . . . where there is a tax on profits the usual consequence of increased profits is the payment of increased tax. Accordingly, taxation on profits does not encourage increased efforts towards efficiency. Where there is a tax on costs, on the other hand, the incidence of taxation is complementary to the businessman's natural aspirations; he has an added incentive to reduce costs and thereby both minimise his tax and maximise his profits". (Para. 37).

As a general statement this may be true. It is, however, open to question in many practical respects.

Businessmen normally conduct their affairs in pursuit of profits; governments generally tax those profits, our own government at a basic rate of 7/3d. in the pound. A Rhodesian entrepreneur seeking to earn any profits at all will, therefore, do so in the knowledge that, broadly speaking, he will receive 12/9d. of each pound and have to hand over the balance of 7/3d. to the fiscus.

Thus the usual consequence of increased profits is not only, as the committee says, the payment of increased tax; it is also the generation of increased profits after tax. It seems to me most likely that, except in rare individual cases, this balance remaining after tax is sufficient incentive to increase pre-tax profits, either by higher prices or by greater efficiency. While accepting, therefore, that a tax on profits may not encourage a search for higher profits through greater efficiency, I doubt whether, at the present Rhodesian tax rates, it discourages that search.

As a matter of fact, I also subscribe in some measure to the modern dogma, or heresy, that the maximisation of profits, whether before or after tax, is not necessarily the prime or even a main objective of the managers of the modern corporation. I accept, however, that a small country such as our own may have a higher proportion of entrepreneurs with a direct interest in the profits of their own businesses than is the case in more mature economies, so I confine myself to mentioning, without pressing this further objection to the committee's reasoning.

To revert to the main line of my argument, I would, I think, accept that a tax on value added, comprising costs and profits, would, in a competitive situation, give some incentive to a reduction in costs. I doubt, however, whether the situation in Rhodesia—or in most other countries—is as competitive as all that; I suspect, instead, that the tax would probably be regarded by a large sector of the community as another element in costs. Its imposition would be treated in much the same way as any other marginal increase in those costs—absorbed in some reduction in profit margins or more probably be incorporated into prices.

To this extent I tend to agree with the view of the British Committee on Turnover Taxation,[5] the Richardson Committee, when it said:—

"Economists would agree that a tax on goods would generally cause prices to rise. The imposition of a tax on a single article may not raise the price by the full amount of the tax . . . When, however, a generalised tax such as a turnover tax or value-added tax is imposed on all goods and services, the tax is likely to be passed on in full . . . ". (Para. 211).

This view has been much criticised, but it seems to me to have a good deal of practical strength. It may overstate the position in suggesting the complete transfer of the tax to the final consumer, but I see little reason to doubt that the bulk will be so transferred.

Our own Committee's remarks add some strength to this view. It said, in part:—

". . . a part of the tax is likely to be passed on and prices would tend to rise". but that:—

"Such pressure as did emerge would not be evenly distributed, nor would it be the only pressure; the general trend of prices is upward and the tax reform, at most, would add force to other factors". (Para. 51).

To digress, this latter paragraph highlights one unfortunate aspect of the Rhodesian Committee's report. Any favourable effects are directly attributed to the proposed tax; most, if not all, unfavourable effects are presented merely as strengthening existing trends. Even if this latter contention is true, a measure which increases the rise in prices from, say, 3% to 5% in a year has itself been solely responsible for a 2% increase in prices and must be judged in the light of that effect rather than excused on the grounds that it has only added force to an underlying trend.

VAT and Company Taxation

Returning from that digression, it must be noted that the Committee in no sense envisages the value added tax as a substitute for the tax on

5 Report of the Committee on Turnover Taxation H.M.S.O. Cmnd. 2300. 1964.

profits, a substitution which, if complete or near complete, might strengthen its argument on efficiency. It proposes, instead, that the introduction of the value added tax at a rate of 7½% should be accompanied by a reduction of the income tax on companies from 7/3d. to 6/- in the pound.

Any additional profits will, therefore, continue to result in the payment of increased taxes. The rate of tax on them will be 7½%, or 1/6 in the pound, plus 6/- in the pound on the balance, or a total of 7/0.6d. This rate, slightly lower than the present, will be the marginal rate of tax where profits are increased by means of increased gross revenue—by a price increase or a larger sales volume. The marginal rate where the profits accrue from a reduction in costs within a static gross revenue will, however, be only 6/-, the 7½% applying equally to costs and profits and, hence, being unaffected by the change in their relative magnitudes.

In present circumstances, therefore, an entrepreneur achieving an additional £1 of profit by way of an increase in total revenue will generally receive 12/9d. of it and pay 7/3d. in tax. Under the new system he will receive 12/11.4d. of it and pay 7/0.6d. in tax. Where he achieves it by way of a reduction in costs without a corresponding reduction in revenue, he now receives 12/9d. net of tax but, under the new system, would benefit to the extent of 14/-.

Finally, a businessman reducing his costs, excluding tax, by £1 will, at the same time, reduce his value added tax to be met from his gross profit margin by 1/6d.—this if he passes on the cost reduction to his customers and reduces his gross revenue accordingly. We thus have three positions, namely:—

(a) if a businessman increases his gross revenue by £1, his costs remaining static, he now retains 12/9d. after tax but would, in future, retain 12/11.4d.—an insignificant change;

(b) if a businessman increases his gross profit within a static revenue by £1—reducing costs and increasing profits by this amount— he now retains 12/9d. after tax; under the proposed system a pound transferred from costs to profits this tax will yield him a net profit after tax of 14/- as opposed to 12/9d. at present;

(c) if a businessman reduces his costs and revenue by £1 his net profit after tax will, at present, be unaffected; if he does so in his pre-tax costs under the new system, the deduction from his gross profit for the new tax will be reduced by 1/6d.—as against this, income tax at the new standard rate of 6/- would reduce the benefit net of that tax to 1/0d.

VAT and Efficiency

It is to the benefits under these two last heads that we must look for the incentive to greater efficiency. It will be noted that a reduction of £1 in costs

passed on to consumers yields an increase in profits after tax of 1/0d.; if not passed on, the benefit is 14/-. Thus, though the tax gives some possible incentive to cost reductions, it is only competition which is likely to reduce prices.

It is, in this connection, possibly worth mentioning that Kaldor[6], in a memorandum generally favourable to the introduction of a value added tax in Britain, saw it as a potential replacement of the purchase tax, the profits tax on companies and the income tax on their undistributed profits. Discussing the resultant effects on efficiency, he concluded that, if the new tax replaced only the purchase and profits taxes—and not the undistributed profits tax—or the purchase tax alone, the advantage would not justify the administrative burden.

I feel, therefore, that the incentive to efficiency provided by a value added tax introduced as a partial substitute for direct taxes on profits should not be over-estimated.

The committee's own comments in this respect, indeed, give an impression of clutching at straws. To quote:—

> " . . . although the Rhodesian economy is not as sophisticated in this respect as that of more developed countries, the Committee does not believe that the introduction of VAT would give no encouragement at all to increased efficiency . . . ". (para. 38).

This is something less than a full-blooded and enthusiastic endorsement of this alleged benefit of the tax.

Equally important, I wonder whether any increase in efficiency promoted by the new tax, would, in the context of the tax's general economic effects, be desirable. The Committee's report states, quite flatly, that:—

> " . . . if there was an improvement in efficiency over only a part of the field of business enterprise in Rhodesia, the economy would benefit." (Para. 38).

Would it? Efficiency, in this context, means, I take it, a reduction in that part of value added not constituting profit. Alternatively, it may mean a reduction in total costs—it being borne in mind that purchases, not entering into value added, have borne tax and that all costs will, therefore, have been subjected to tax in the hands of the processor concerned or at some earlier level of production.

Efficiency in this sense could be desirable for a number of reasons. It could be desirable if its result was to increase the total volume of production. This could, of course, come about if the increase in efficiency was reflected in lower prices, both at home and in export markets.

6 Essays on Economic Policy, Vol. 1, pp.266 et seq.

VAT and the Level of Demand

But the effect of the tax is, as I have indicated, likely to be some additional tendency to increased prices. It is, therefore, unlikely in isolation to promote, but instead likely to depress the level or reduce the growth of domestic demand expressed in real, not money terms.

Its effects in this respect would be accentuated in two other ways. In the first place, the value added tax on consumption expenditure is, in my view, inherently regressive. It falls with greatest strength on those with a high propensity to consume, which usually means the low income groups.

For this reason, one might expect its introduction to be associated with measures rendering the rest of the tax system more, rather than less progressive, thus at least maintaining the present degree of progression. It seems, however, that the committee's proposals are not directed to this end. Of the major consequential changes suggested in the tax system, the reduction in the maximum rates of income tax and the elimination of supertax would reduce the element of progression in the tax system. As against this the abolition of personal tax might have some opposite effects—the remaining tax changes are merely incidental and, in this connection irrelevant.

On balance I suggest that the committee's proposals in respect of other taxes probably do not reduce the basically regressive nature of the value added tax and that the overall effect of the changes suggested is, in consequence, to reduce the progression or add to the regression of the tax system.

I must here note that the Committee itself says:—

> " . . . although a narrow view of the changes outlined in the hypothetical scheme might cause them to be regarded as regressive in nature, a wider view, taking in their longer term effects, could lead to the opposite conclusion". (Para. 63).

In the absence of any clear explanation of the "wider view", I tend, therefore, to what the Committee describes as a "narrow view".

On my "narrow view" it seems to me that the tax being regressive, falling most heavily on those with a high propensity to consume, and the tax concessions, by contrast, tending to benefit those with a higher propensity to save, its introduction is likely, at least initially, to have some depressing effect on domestic consumer demand.

The second of the factors accentuating the depressing effect of the tax on domestic consumer demand is that the search for efficiency, which is seen—though not by me—as one of the main beneficial effects of the value added tax, will, if it takes place, tend in some fair measure to concentrate

on a reduction in the semi and unskilled labour force. This is, after all, one of the components in costs, or value added, most easily varied in the short term.

To the extent that this reduces—or limits the rate of growth—of employment, it will reinforce the tendency of the new tax to depress the level or reduce the rate of growth of the domestic market.

A subsidiary point is that the proposed value added tax, allowing for the deduction from taxable income of all capital purchases and requiring the inclusion in it only of the residual value of capital goods sold provides no disincentive and, possibly, some incentive towards investment in more capital-intensive means of production. Sullivan, for example, notes that:—

> " . . . a study by the German Ministry of Finance of the application of the French value-added tax in Saarland reached the conclusion that the exemption of investment goods severely discriminates in favour of capital-intensive enterprises as against those which are labour-intensive". (Page 122).

My point, thus far, is that:—

(a) the introduction of the value added tax is likely to add to the upward pressure on domestic prices and, hence, to depress the size or growth of the domestic market—as the Committee put it, "If prices rose and earnings remained static there would be a contraction in demand, especially at the lower levels where little or no saving is possible". (Para. 62).

(b) this depressant effect is likely to be accentuated by the regressive nature of the tax taken with the other changes proposed in the fiscal system, which will tend to redistribute incomes from those with the highest to those with lower propensities to consume; and

(c) the depressant effect is likely to be further accentuated by a tendency for the search for "efficiency" postulated by advocates of the tax to reduce the level, or limit the growth of employment.

This last point was, of course, not overlooked by the Committee, which remarked:—

> "If increased productivity of labour and greater capitalisation were not accompanied by a corresponding increase in the volume of production there would be some unemployment or at least a further decline in the rate of absorption of labour; however, it would be reasonable to expect that the volume of production would also rise, especially if VAT succeeded in accelerating the development of exports, and that further employment opportunities would thus be created". (Para. 60.)

Exports

I have given my reasons for discounting the prospects of a rise in production for domestic consumption, so what of exports to whose growth the Committee clearly attached some importance? Here one has an almost unanimous chorus in praise of the tax. It should not be levied on exports, thereby giving an incentive to exporters. This is an incentive which does not constitute dumping but which instead complies with the code of international behaviour contained in, for example, the GATT. In the words of "1066 and All That", it is a Good Thing.

Yet I wonder whether the introduction of the new tax will have any markedly stimulant effect on our exports. These will be relieved of the value added tax—and profits accruing from them will, of course, in principle, be taxed at only 6/- instead of 7/3d. in the pound.

A simple relief from the value added tax will, of course, reduce the total costs of production, including tax, of the exported product below that of the like product made for domestic consumptoin. It will not, however, of itself reduce the costs of the export below its present untaxed level.

It is only if the influence of the value added tax in increasing efficiency —an influence stemming from its effects on domestic transactions and one I have suggested is over-stated—spills over to exports, as well it might in the case of firms producing like goods for sale at home and abroad that a cost reduction might strengthen the competitive position of Rhodesian goods abroad.

Even then, and assuming that producers passed on this cost reduction to foreign customers in the form of reduced prices, the resultant increase in the volume of export sales would depend entirely on the elasticity of demand in foreign markets. Whether or not this would be great enough to offset the depression of domestic demand resulting directly from the probable increase in prices and indirectly from the redistribution of incomes and the possible reduction in employment or its rate of growth is surely a moot point.

Possibly more important is the point that the relief of exports from the tax should increase the relative profitability of export sales compared with domestic sales. This might give businessmen an incentive to go out and sell more abroad, but I am inclined to doubt its effectiveness as a major stimulant of the volume of domestic output. Once again, the expansion of exports would be largely a reflection of the elasticity of demand in foreign markets. In addition, the tax concessions lately allowed to exporters represent, I suggest, a far more potent incentive to the development of external trade to which

the new tax could at best make a marginal addition. Though this potential marginal benefit should not be ignored, it seems plain that it cannot of itself justify, or even add much to the justification of the introduction of the new tax.

VAT and the Wage Level

Finally, the rise in prices the new tax is likely to cause will, it must be recognised, probably be accompanied by an upward pressure on wage levels. This is, in guarded or qualified terms, recognised by the Committee. Thus:—

> "Any (price) increases that did occur would encourage demands for higher wages . . . ". (Para. 54).

and:—

> " . . . the worst possible increase in consumer prices arising from the introduction of VAT is not large in relation to the normal annual movement in wages and prices. It is, however, sufficiently large to justify giving consideration to phasing the introduction of the tax over, say, three or four years". (Para. 56).

While the committee may be right in its view that the potential effects of the tax on price and wage levels are not great by comparison with the "normal" rising trend, they must represent some acceleration of the upward drift. On this basis, it seems to me fair to postulate that:—

(a) the accelerated wage drift will, to some extent and over a period of time, operate to reverse the initial redistributive effects of the committee's tax proposals on disposable incomes, net of taxes; and

(b) this will in turn operate to minimise the depressing effects of the initial tax changes on the volume of domestic demand; but

(c) it will increase the pressure to reduce costs by reducing the size, or at least the growth of the labour force, strengthening that potential depressant of domestic demand; and

(d) it will tend to weaken the competitive strength of the country's exports, thus offsetting any effects of the new tax in stimulating exports.

To sum up, it seems to be that the "efficiency", to whose promotion the advocates of the value added tax attach considerable importance, may, in Rhodesian conditions and given the manner of introduction of the tax suggested by the Committee, prove something less than a boon. I suggest that the effects of the tax in promoting efficiency are probably overstated, that the tax may, despite any additional efficiency achieved, have a depressing effect on the volume of demand and, hence, of domestic production and that

its main effect in this field may prove to be a reduction in employment below the levels it would otherwise have achieved. I find it remarkable that a country where labour is the factor of production in abundant—indeed over-abundant—supply should see any merit in this last potential effect of the tax.

The African Peasant Farmer

My broad fears in this respect are compounded by the particular position in which our peasant farmers are likely to find themselves. A large-scale, or European farmer will, effectively, pay 7½% on the gross value of his production —this is the effect of taxing him at 7½% on his value added, being his gross revenue from sales less those of his input items already taxed at 7½%. A small-scale African peasant farmer will pay the 7½% tax incorporated in the price of his input items, but will not himself pay that tax on his own added value. To this point, the African peasant is in a preferred position.

But the buyer of produce from the European farmer can deduct its entire value from his gross revenue to arrive at his own taxable value added. The result will be that his sales, like those of the farmer, will effectively have been taxed at 7½% on their total value.

The buyer of produce from the peasant will not, however, be able to deduct its cost from his subsequent sales revenue. He will, instead, have to pay the 7½% tax on it as well as on his own added value. Thus the produce of a non-taxable producer will be worth less to him than that of a taxable producer and his natural reaction will be to reduce the price paid for the former by the amount of his additional tax liability arising from its use.

This would not place the peasant producer at any disadvantage if he had no taxed inputs. It would mean only that he was burdened by the tax as a reduction in the price paid to him rather than as a deduction made by him from his receipts. But, where he has such taxed inputs—and their amount must rise if peasant agriculture is to be developed—he will be at a disadvantage. His whole produce will be taxed at the standard rate without allowance for the tax already incorporated in his inputs. He will, in effect, be subject to double taxation.

I think we all agree that it is essential to Rhodesia's economic future that the productivity of our peasant farmers be increased and increased rapidly. Any adverse effect of the new tax on this process is, in consequence, deplorable.

The Committee itself recognised this problem, though specifically in terms of the increased cost of input materials rather than the depressed value of the products to its purchaser.

It said that it:—

" . . agreed that the tribesmen should be assisted to overcome this difficulty, but felt that it was not in a position to suggest the means by which this could best be done . . .". (Para. 70).

I harbour most serious doubts of whether such means can be found which will at one and the same time relieve peasant farmers of any disadvantage, avoid giving them an unjustifiably preferred position and recognise their different levels of advancement and efficiency. Yet this must be done if a serious objection to the new tax is to be removed.

Effect on Investment

Before summing up my remarks, I should like to deal, albeit briefly, with two other points. The first is the effect of the new tax on investment. The Committee claims that, with higher prices offset by lower taxes as far as those with incomes sufficient to yield substantial savings are concerned, there is no reason to expect the level of savings to be markedly affected. I do not dispute this.

The Committee also remarks that, if the tax raised efficiency and reduced taxes on profits " . . . not only would existing resources be more fully exploited but projects hitherto regarded as uneconomic could be profitably developed." (Para. 44). It links this with an allegedly favourable effect of the tax on the inflow of capital.

This line of argument seems to me to some extent ill-founded. The proposals are not intended to reduce the overall incidence of the taxation on the economy; they merely redistribute it. In so doing, they are, I have suggested, likely to redistribute it in such a way as to reduce the effective level of consumer demand. This redistributive effect may, in time, be offset by an accelerated rise in the earnings of those low down the economic scale, reducing the present very wide range of incomes. This would, however, both weaken the competitive position of Rhodesian products at home and abroad, offsetting any higher efficiency secured through the working of the tax, and reduce the volume of employment below the level otherwise reached. It cannot, therefore, be looked to as a restorative of the level of demand.

Then savings in isolation have little to commend them, while investment is, surely, undertaken in the light of an assessment of likely future market trends. If the growth of the market given the new tax is likely to be slower than without it—a possibility which should, I believe, be seriously considered —then the tax is likely to be a disincentive, not an incentive to investment. Any effect it might have in this respect would, over time and through the operation of the multiplier, of course, tend to be cumulative.

Economic Planning

The second of the points to which I wish briefly to refer is the role of the tax in planning. Some advocates of the value-added tax undoubtedly view it as a means of controlling the level of private consumption expenditure and, hence, as at least one means of causing the nation's expenditure to be distributed between the private and public sectors and between consumption and expenditure in accordance with some pre-determined plan.

This view certainly underlies the element of administrative flexibility in rates of purchase and excise taxes introduced in Britain in 1961. It must also account for our own Committee's remark that:—

> " . . . indirect taxes such as VAT can be used much more effectively than income tax as an ecomonic regulator since changes in the level of tax can be brought to bear more quickly". (Para. 64).

I am, as you have gathered, no admirer of economic planning, whether of the Communist mandatory or French indicative variants, but I do accept a need for the state from time to time to intervene to influence the levels of consumption, investment and so on. I doubt, however, whether its intervention can be, or should seek to be frequent and precise; I believe, instead, that the most which can reasonably be attempted is the acceleration or reversal of general trends, a course requiring only more occasional intervention. For this reason I discount the value of the new tax as an ecomonic regulator.

What is more, I have no claim to be an expert on the French economy, but I have, in preparation for this paper, sought information on the use of that country's value-added tax as a regulator. I have sought in vain; I have found no reference to its use as a major effective element in the control of private consumption or even to any frequent or major alteration in its rates reflecting its attempted use in this role.

I wonder whether the explanation is not at least partly given by the Irish economist I earlier quoted:—

> "Some economists go so far as to think that the rate of turnover tax can be varied up or down according to the necessity to restrict private spending. This, in my view, is a totally unrealistic approach. So far as Ireland is concerned, it does not take account of the two major factors which arose in our economy; the practical difficulty which business had in dealing with even a fixed rate of tax, and the trade union pressure which came after the introduction of the turnover tax for increased wages because of changes in the price level". (M. J. MacCormac p. 9).

Conclusions

I fear my remarks this evening have to some extent taken the form of a criticism of our Rhodesian Committee's report. I do think, however, that it, following other advocates of the value added tax, has in some respects claimed too much in favour of, and conceded too little against the tax.

I frankly admit that, for my part, I was myself until recently a firm advocate of the tax. I have still not renounced it, but am now less satisfied of its merits, which I earlier took for granted. I wonder whether our Committee, and the Government which may carry out its recommendations, may not also have taken too favourable a view of something new, something gaining growing acceptance but in conditions remote from our own, something at least partly sanctified by its French origin.

But I must leave you with one further thought. Benjamin Franklin once wrote:—

" . . . in this world nothing can be said to be certain, except death or taxes".

We can assume taxes to be a certain feature of our future and all we are here discussing is the, to me, subsidiary point of how to levy them. This is a subject which some may find fascinating and which deserves serious thought. It should not, however, be allowed to generate heated argument and dissension.

Salisbury.