

**AN ENQUIRY INTO THE FACTORS AFFECTING THE DEVELOPMENT
OF THE SOUTH AFRICAN TAX STRUCTURE (1946/47 - 1985/86)**

by

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In memory of my Father.

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ABSTRACT

The objective of this thesis is the provision of explanations for the changes in the South African tax structure between 1946 and 1985. The method of enquiry comprises an evaluation of three theoretical perspectives evident in the literature, referred to throughout as the economic development, public choice and marxist approaches. The central conclusion to emerge from this study is that whilst each of these perspectives individually provides valuable insights, by far the most structured explanation relies on an eclectic exposition which incorporates the relevant contributions of all three approaches.

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INTRODUCTION

The South African tax structure¹ has undergone considerable development and change over the last forty years. Yet, in spite of this, there has been no serious attempt made in the literature to examine the origins and causes of these changes, or even adequately to describe their evolution.

Contributions by De V. Graaff (1968), Trotter (1969), Krogh (1969), Browne (1983), Kantor (1985, 1986a, 1986b) and others,² have undoubtedly generated some valuable insights into certain areas of the tax system. However, none of these studies has endeavoured to provide an historical analysis of tax structure change over time. Nor has any attempted to develop a systematic exposition for the multitude of tax innovations which have characterized this period. As a result, little is known about this aspect of South African public finance.³

This thesis addresses itself to these questions, with the major objective being the provision of explanations for the changes in the South African tax structure between 1946 and 1985.

In this respect it is stressed that this study is primarily an exercise in positive economic analysis. Moreover, following Buchanan (1975:389), it is predominantly an enquiry into 'the expanded domain for positive analysis' which goes beyond the measurement of the effects of taxes on individuals and firms, and looks toward understanding the reasons behind various tax initiatives.

Consequently, so far as possible, no value judgements are made. Nor is this thesis a critical evaluation of tax policy. Indeed,

normative economics has adequately taken care of what ought to be. Beginning with Adam Smith (1784), the ability to pay and benefit principles have been thoroughly scrutinized in the literature, and modern contributions in this area have established numerous guidelines for equitable tax policy (see e.g., Sandmo, 1976; Samuelson, 1986). Yet, evidence suggests that the principles which characterize these studies, and which should be incorporated into the formulation of modern day tax policy, are invariably neglected by politicians and taxing authorities (Head and Bird, 1983:3; Ricketts, 1981:29). Often, because of the heavy demands placed on the budget, normative considerations only begin to form part of taxation philosophy when they coincide with other objectives and requirements.

This realization necessitates the development of a positive approach. In short, as Bartlett (1975:v) states, 'we ask not what should be, we seek only to discover what is'.

Surprisingly though, this particular field of economic enquiry has been relatively overlooked. Buchanan makes exactly this point in his review of the trend in post-Marshallian positive analysis:

"Positive analysis was restricted almost exclusively to the theories of tax shifting and incidence.....Within limits, and for certain simple forms, the economist could confidently predict the effects of a tax on the behaviour of persons and firms in the private economy, and, through this, on the aggregate effects on such variables as relative prices, outputs, profits and industry structure in particular sectors. For this positive analysis,....the economist had no reason to enquire about the political purpose of taxation, no reason to introduce external evaluation of alternative tax instruments." (Buchanan, J., 1975, p.383).

Thus, whilst positive analysis in taxation has successfully developed powerful tools useful in understanding the impact of taxes, shifting, incidence, and the effect that various taxes have on saving, leisure, and inflation, very few economists have questioned the sources of taxes or the determinants of tax structure change. As Hansen notes:

" In general, a tax to be analysed is an experimental treatment, a 'deus ex machina' whose effect can be observed, but whose origins are investigated in a cursory fashion if at all."

(Hansen, B., 1983, p.18).

The standard response by contemporary economists to criticism of this type, is to maintain that any enquiry into the origins of taxes and analysis of the decisions made about taxes and tax rates, remains largely outside the boundaries of economics in the sphere of other disciplines, usually politics. As a result, economists, in general, have tended to regard the selection and examination of the so-called 'non-economic variables' as the concern of 'other social sciences' rather than their own (Peacock and Wiseman, 1967:vii).

However, whilst this exclusion may be justified in certain cases, the same cannot be taken to apply here. This is because, in reality, a complicated mix of economic, political and social factors determines tax structure change over time, and the failure to account for all of these can only lead to partial answers (see Alt and Crystal, 1983:3). Adequately incorporating these factors, however, enables one to formulate an organised approach to interpreting historical change.

On the other hand, one view expressed maintains that this type of enquiry can produce only limited results. Kaufmann and Larkey (1980) contend that tax structures evolve as a direct result of a cumulative and largely unintended solution to a succession of annual budget problems. The null hypothesis, as such, maintains that tax structures evolve from a series of ad-hoc decisions made yearly at budget time to suit the requirements of the day. The implication of this is that no amount of investigation will reveal anything but an irregular and generally random pattern of government decision making.

This, however, may not be the case⁴. Indeed, the underlying contention developed in this thesis maintains that the process of tax structure evolution in South Africa has essentially followed a predictable path, much of which can be successfully interpreted within the scope of the existing literature.⁵

The study is broadly divided up into three main parts - theory, evidence and interpretation.

In Chapter 1, three possible theoretical approaches to interpreting tax structure change are discussed, namely; the economic development, public choice and marxist approaches. These three distinct perspectives are evident in the literature reviewed, and each individually provides a means whereby various facets of change may be interpreted. Together, by highlighting and concentrating on different themes, they provide a suitable theoretical format for analysis.

Thereafter in Chapter 2, the South African evidence is presented, focussing on major structural changes, tax innovations and policy realignments which have occurred in the forty year period under review. Here, the emphasis is on description, the sole purpose being to provide the historical and statistical material required for the explanatory chapters that follow.

Chapters 3 to 5 are concerned with interpretation. Separately, in each of these chapters, the primary aim is to evaluate how well each of the three theoretical approaches formulated, accounts for the South African experience. It is thus not expected that each individual approach fully explain all facets of change, but rather that each argument be used to explore those aspects of taxation which fall within its ambit.

In the final section of this thesis, the major findings and conclusions derived from each of these chapters are re-examined, contrasted and compared. Unresolved issues are also discussed, and the overall objective is to consolidate the different contributions into a more unified perspective.

The scope of this thesis is limited to a study of post-World War II taxation, referring to pre-1946 only where necessary. There are three main reasons for this. Firstly, and most importantly, 1946 marks the beginning of the development of the South African economy in the post-war period. Secondly, although tax policy had undergone some change since Union (1910), significant developments only began to emerge after 1947 (see Browne, 1983). Thirdly, the NP victory in the 1948 election was to have profound effects within South Africa both politically and economically.

A second limitation, is that this thesis is confined to an examination of the finances of the Central government only. The provincial and local authorities, which represent the two lower tiers of government, have been largely ignored. This exclusion may be justified on the grounds that the Central government collects some 90% of total revenues and is therefore considered the most appropriate for analysis⁶.

Finally, this study concentrates on the taxation side of the fiscal process, and for the most part expenditure issues are not well developed. However, as will become evident, all the major concepts dealt with in the following chapters can be successfully advanced without directly including expenditure considerations. Consequently, they are referred to only at such times as when they are regarded as crucial to the validity of the argument.

PART ONE: THEORY

CHAPTER ONE: THEORETICAL APPROACHES TO TAX STRUCTURE CHANGE

1.1 Introduction

Since few studies¹ have directed their attention specifically to providing an explanation for the process of tax structure change, the first task involves synthesizing relevant contributions into a general theoretical format which can be used as a basis for interpretation and analysis.

From an examination of the literature associated with taxes and tax structures, three distinct approaches to the subject could be determined. Individually, the approaches are unique, in that each attempts to provide its own explanation and rationale for tax structure evolution by stressing different elements of change. Together, they provide a suitable theoretical format for discussion.

The first approach - the economic development approach, emphasizes the notion that changes in the tax structure are primarily determined by changes in the country's stage of economic development. In this perspective, particularly relevant for developing countries, the availability of tax bases,² tax 'handles',³ taxable capacity,⁴ and the costs of collection, hold the key to understanding a number of features of tax structure change.

The second approach essentially follows on from the first, and investigates the role that political factors play in the deter-

mination of tax policy, and consequently tax structures. Generally speaking, this approach takes the stage of economic development as given, and within the scope of positive public choice, discusses the most important variables which can be expected to influence decisions taken by politicians and voters about taxes.

The marxist approach is the final contribution to the analysis. This perspective introduces 'class' into the discussion, basically viewing tax structures as a product of both the development of the productive forces as well as of the system of social relations. Although it is the least explored in the literature, it provides an interesting and alternative means with which to view the progression of tax structures over time.

1.2 The Economic Development Approach

The notion that there exists some relationship between the structure of taxation and the level of economic development has been the subject of considerable research since the late 'fifties. These studies, many of which were conducted under the ambit of the International Monetary Fund (IMF), are based on the premise that the structure of taxation in a country is principally determined by the stage of economic development reached. This premise itself, is based on the assumption that economic development is the most important determinant affecting the range and size of tax bases and 'handles' which ultimately form the foundation of the whole tax system (see Musgrave, 1969).

This approach to interpreting tax structure change is divided up into three main sections. The first section consists of a survey

of those studies which have attempted to relate the tax ratio to various measurable indices of economic development. This is followed with a review of the only two significant attempts made to interpret the process of tax structure evolution within a dynamic framework of economic development. The final section concludes with a look at the important role that the cost of collections play in the evolution of tax structures.

1.2.1 The Tax Ratio and Economic Development

Possibly the most general representative measure of the nature of a country's tax structure, is the size of the overall 'tax ratio' (generally expressed as a measure of total tax collections to GDP or GNP (Chelliah, 1971:256-260)). Representing the total value of resources transferred from the private sector to the public sector through the process of taxation, it is often the main criterion used by economists in evaluating how a particular country's tax 'burden' has changed over time (e.g., Krogh, 1969:294). Despite definitional and measurement problems, it is also the principal measure used for making inter-country comparisons (e.g., Cameron, 1978).

Following Goode (1984:84-86), the size of the tax ratio is determined by the interaction of a number of factors, the most important of which include;

- a) The demand for government expenditure;
- b) The taxable capacity of a country;
- c) The availability and 'willingness' to use non-tax sources of finance such as borrowing and money creation.⁵

a) The Demand For Government Expenditure

For developed economies, possibly the most important demand side determinant influencing the size of the tax ratio, is the demand for government expenditure (Lotz and Morss, 1970:328). Unless there is continued recourse to borrowing, the more goods and services that governments are called on to provide, the greater is the level of resources (taxes) needed to finance it (see Anderson, 1986:631). Consequently, taxation and expenditure are inextricably linked together in the total fiscal process in those countries in which a fairly conservative ('balanced') approach is taken to public finance.

The significance of the relationship that exists between the two sides of the budget, is clearly evident in the two major hypotheses which dominate attempts to find an explanation for government expenditure growth (see Larkey et al, 1981). Although primarily concerned with expenditure issues, they also provide some valuable insights for this study.

Perhaps the best known of these is Wagner's so-called 'law of increasing state activity' (Wagner, 1877, 1890). This 'law' postulates that as per capita income rises in an industrialising country, so the public sector (and consequently the size of the tax ratio) can be expected to expand in relative importance.

Wagner offered three main reasons as to why this growth might occur (Bird, 1974:2-4):

Firstly, Wagner contended that the costs of the administrative and protective functions of the State would rise, due to the substitution of public for private activity, population growth, urbanisation and increased complexity of legal relationships, all of which Wagner expected would accompany industrialization.

Secondly, Wagner anticipated growth in cultural and welfare expenditures (e.g., education, income redistribution) more than in proportion to increases in national income, since these expenditures are superior in nature (i.e., having an income elasticity greater than 1).

Thirdly, Wagner envisaged an expansion in the role of the State, as a result of the State's need to overtake monopolies (brought about through changes in technology and scale economies) in the interests of economic efficiency. He further predicted that the State may in the first instance be forced to provide those services (such as railways) which are natural monopolies, often beyond the reach of private capital.

The applicability of Wagner's 'law', although subject to a number of definitions (Ghandi, 1971), has been questioned in a number of empirical tests (see Gupta, 1967; Musgrave, 1969; Ganti and Koluri, 1979; Bird, 1974; Cameron, 1978; Abizadeh and Gray, 1985). Overall, the general consensus suggests that:

"...on balance.....the evidence imperfect and scanty as it is appears to support Wagner's 'law'."
(Bird, R., 1974, p.15).⁶

The second major attempt to provide an explanation for the trend in government expenditures, was Peacock and Wiseman's (1967, 1979) Displacement Hypothesis. Endeavouring to find a rationale for discrete shifts in government expenditure observed in Great Britain, their enquiry found support for the notion that the supply of revenue remains bound to the level of taxation that the public will tolerate.

"In settled times, notions about taxation are likely to be more influential than ideas about desirable increases in expenditure in deciding the size and rate of growth of the public sector. There may thus be a persistent divergence between ideas about desirable spending and ideas about the limits of taxation. This divergence may be narrowed by large-scale social disturbances such as major wars. Such disturbances may create a displacement effect, shifting public revenue and expenditure to new levels. After the disturbance is over new ideas of tolerable tax levels emerge, and a new plateau of expenditure may be reached with public expenditure again taking a broadly constant share of gross national product, though a different share of the former one." (Peacock, A. and Wiseman, J., 1967, p.xxxiv).

This hypothesis, although somewhat difficult to measure accurately (due to the vagueness of what constitutes a social 'disturbance'), has nevertheless been evaluated in a number of econometric studies (e.g., Marr, 1974; Diamond, 1976). With the results generally mixed, the lack of conclusive agreement indicates even less empirical support for this hypothesis, than is the case for Wagner's 'law'.

Evidence aside though, what is important to note for this study, is that the two hypotheses differ quite substantially on the degree to which taxation can be expected to act as a constraint on government expenditure.

In the first approach, there is no possibility of a revenue constraint since Wagner believed⁷ that '....in the long run the desire for development of a progressive people will always overcome these financial difficulties' (see Musgrave and Peacock, 1958:8). This naturally implies that public expenditures are the 'principal force' determining the level of revenues (Thorn,

1967:27). In the second, the opposite applies, with government expenditures generally revenue constrained as a result of strong taxpayer resistance to unwarranted tax increases.

Clearly though, the possibility of a revenue constraint also varies for different countries according to the stage of economic development reached. In the case of undeveloped and developing countries, the inability of the tax system to raise the required revenues may in itself serve to operate as a constraint on government expenditure. The size of revenue collections in these countries is, therefore, primarily a function of revenue capacity. On the other hand, in the case of developed countries, the sequence may run the other way, i.e., expenditure requirements determining the level of revenues raised, within broad economic and political constraints (Lotz, 1970:123; Krzyaniak, 1974; see also; Anderson et al, 1986).

b) Taxable Capacity

The taxable capacity of a country is the second major determinant influencing the size of the tax ratio, and the one on which we focus our attention. Broadly speaking, it is dependant on two major factors. The first is the ability of people to pay taxes, a necessary prerequisite and one which indicates the existence of taxable 'surplus'. The second, is the ability of government to realize this surplus in the form of revenue collections, i.e., the existence of a tax base, and a feasible tax 'handle'. This latter ability is itself affected by the quality of revenue staff, efficiency in collection, and the degree of sophistication in the method of tax assessment (Chelliah, 1971:292; Prest,

1978:13-31).

During the course of economic development, the taxable capacity of a country increases, and coupled with unlimited demands for government expenditure is assumed fully reflected in the size of the overall tax ratio (Radian, 1980:31; Thorn, 1967:23).

In an effort to isolate the factors which determine taxable capacity, a number of studies have directed their attention specifically to finding out what kind of statistical relationship exists between the tax ratio and certain measurable indices of economic growth. Using mainly static cross-sectional models, these studies have together been fairly successful in being able to relate the tax ratio to three separate variables: per capita income, the 'degree of openness' of the economy, and the structural composition of GDP, all of which can be regarded as proxies for taxable capacity.

In perhaps the earliest study of taxable capacity, Martin and Lewis (1956) made the first attempt to find out what patterns of revenue were appropriate to different levels of economic development. In their 1953-54 data, they found six developed and ten less-developed countries with tax ratios between 17% and 23%, and 8% and 22% respectively. They also considered the impact of ideology and public sector productivity on revenue collections. Unfortunately, the small, and in many respects biased sample used prevented their results being taken seriously (Williamson, 1961).

At roughly the same time, a study by Oshima (1957), using a larger sample of 32 countries for the period 1948-54, recorded

similar results. Although not using any formal statistical methods, Oshima concluded that the larger tax ratios found in developed countries could be explained by their higher level of productivity relative to less-developed countries. This productivity differential, by producing a larger margin of income (taxable surplus) above physical subsistence, enabled governments of developed countries to realize greater amounts of tax. In short, Oshima observed that much more is available for taxation after consumption needs have been fulfilled. As Kaldor puts it:

".....the taxation potential of a country depends on the excess of its actual consumption over the minimal essential consumption of the population."
(Kaldor, N., 1965, p.3).

As was the case with Martin and Lewis, Oshima used an income per capita measure to differentiate between developed and developing countries. Using this measure, he identified a pattern in which high per capita income countries were characterized by larger tax ratios than countries with lower per capita income levels (see also; Musgrave and Musgrave, 1985:791).

The use of per capita income in this study was based on the rationale that a higher per capita income reflects a higher level of economic development. This implies greater taxable capacity, usually associated with a highly organised business sector, a high literacy rate, the predominance of cash crops etc., all of which facilitate more efficient levying, ability to pay (taxable surplus) and collection capabilities.

In the earliest formal statistical analysis, Williamson (1961) analysed 30 countries in a follow-up study of Martin and Lewis.

He used per capita income as the principal indicator of the stage of economic development reached. Making use of 1950-57 data, he confirmed the results of both Martin and Lewis and of Oshima, and found significant support for the use of per capita income in explaining international variations in the tax ratio. In addition, Williamson found that the composition of revenue collections tended to shift from indirect to direct tax receipts with economic development and growth in per capita income.

Williamson argued that the rising trend of the tax ratio could be explained by the relative unproductiveness of the public sector. Like Martin and Lewis (1956), he contended (with the help of previous studies on sectoral productivity) that the labour-intensive government being less productive than the capital-intensive private sector, would need a larger proportion of revenue to provide a constant supply of output. This tendency would in turn be further driven by the demand for government expenditure, as postulated in the Rostowian Growth thesis (See also; Baumol, 1967; Buchanan, 1977:7).

In 1965, Harley Hinrichs continued with the tradition of using per capita income in his study of some sixty developed and developing countries. Although initially finding some support for this variable in his 1957-60 data, he found that this same relationship did not hold for the two groups taken separately. In its place, Hinrichs put forward the notion (although without much rigorous proof!), that tax ratios in developing countries were more likely to be related to the 'degree of openness' of the economy (expressed as a ratio of imports to GNP).

Hinrich's rationale for the inclusion of the 'openness' variable into the equation hinged on two complementary factors. The first relied on the notion that taxing the foreign trade sector is characterised by relative 'ease of collection'. That is to say, since the activities of importers and exporters usually remain confined to a limited number of concerns (especially in the case of developing countries), the collection of taxes from these units becomes a relatively uncomplicated and cost effective process. Centralised collection points, such as borders and harbours, are further contributory factors.

Developing similar ideas, Lewis has also stressed this same point:

"The biggest yielders of revenue in underdeveloped countries are the taxes on commodities, import, export and excise duties. These are the easiest to collect administratively when commodities pass through the hands of a few wholesalers in a small number of places. This is why the countries that raise most in taxes are those which depend most on foreign trade."

(Lewis, A., 1966, p.21).

The second factor relies on the 'spillover effect' that the foreign trade sector can be expected to have on the ability to collect taxes in other parts of the country. Simply, the degree of 'openness' represents a proxy indicator not only for the size of the foreign trade tax base, but also for the depth of the total tax base, as is the case with per capita income.

In a study by Lotz and Morse (1967), they included both the per capita income and 'openness' variables in a 72 country study and found both factors statistically significant in explaining tax

ratio variations in developed and developing countries. They also incorporated the degree of monetization and the role of government centralization into their analysis as possible explanatory variables, finding limited support.

Until this stage, very little emphasis had been placed on the role of social and political factors as determinants in the size of revenue collections. Thorn (1967), realising this neglect, and utilising the contribution of Adelman and Morris (1965) (on the relationship between sociopolitical factors and per capita income), emphasized the role of government decentralization and the effect of colonial influence in his sample, but without much success.

Shin (1969) and especially Weiss (1969), who also believed this to be the 'missing link' in these studies, incorporated them into their analysis. As was the case with Thorn, this was done mainly through the inclusion of dummy variables as proxies for factors such as urbanisation, monetisation and centralisation. However, despite substantially improving the statistical fit (R^2), the dummies did little to improve the overall conceptual understanding.

In a major study directed specifically at developing countries, Chelliah (1971) introduced into his analysis the importance of the structure of the economy (i.e., composition of GDP) as a further explanatory variable. In his study of fifty countries, Chelliah used the share of mining in the total economy as an index of economic growth, and found support for its inclusion as well as some support for the other two 'established' variables.

Chelliah, in fact followed on from Shin (1969), who had used a share of agriculture in his study, and in turn was followed by Bahl (1971) in a slightly different study which included both.

The inclusion of mining as a variable was based on both capacity and 'willingness' factors. Firstly, in terms of capacity factors, a changing composition of GDP holds direct implications for the tax ratio due to the different contributions that each sector offers in the way of taxable surplus, depending upon its relative productivity and efficiency. As such, for a given set of taxes and tax rates, a variation in the composition of GDP over time, should eventually manifest itself in a transformation of the size and composition of revenue collections.

Secondly, in terms of 'willingness' factors (a concept not previously incorporated into the analysis), Chelliah notes how different sectors vary in their suitability as feasible tax bases. For example, foreign ownership of the mining sector, invariably predisposes governments (especially in developing countries) to tax the mining sector more heavily than others. Similarly, other sectors (such as the rural sector) which often provide the backbone of electoral support, may be underutilised. In addition, different sectors also vary considerably in their suitability as tax bases from a purely administrative point of view. Agriculture, for example, is notoriously difficult to tax, unlike the highly monetised wholesale and tertiary sectors.

In one of the more recent studies undertaken by the IMF (Tait, Gratz, et al, 1979), these three variables; per capita income, the 'degree of openness' and the structural composition of GDP

(albeit with a few others) were included in a sample of 63 developing countries. Together, they successfully explain some 40-60% of the variations observed in international tax ratios.

Reviewing these results, Goode remarks:

" While these figures may seem low, they are impressive in light of the complexity of forces that bear on taxation and the results obtained in other studies of economic and political behaviour."

(Goode, R., 1984, p.87).

Nevertheless, mention should be made of some of the more severe limitations of the studies mentioned thus far.

Firstly, the successful measurement of taxable capacity (the primary aim of these studies), depends critically on the a priori justification that the variables used in these regression studies affect the taxable side of the equation only, having little or no effect on demand factors. For example, whilst per capita income is an accepted proxy for potentially higher tax ratios due to its effect on capacity, it is also a powerful argument on the demand side for government expenditures (Goode, 1984:85). This implies greater discretionary involvement in revenue raising, especially in the case of developed countries in which demand factors assume even greater proportions (Lotz and Morss, 1970:328).

In fact, the problematic use of per capita income as an indicator of taxable capacity extends even further. Afxentiou (1980:131) notes that whilst the assumption that the higher per capita income the higher taxable capacity is 'roughly correct as a general statement', he goes on to point out that not all of

taxable capacity is transformed automatically into tax collection, and nor is every dollar of per capita income taxed uniformly. The treatment of all GNP as taxable surplus is, therefore, largely inappropriate, especially in developing and undeveloped countries in which per capita income levels may represent levels of subsistence, having little or no effect on the ability to pay taxes. Furthermore, if the actual distribution of income is highly skewed itself, little can be said about changes in taxable capacity simply from changes in levels of per capita income.

Secondly, the use of different sectors of the economy (e.g., agriculture and mining) as indices for the structure of the economy, ignores the 'fuzzy' line in the distinction between actual taxable capacity and the 'willingness' to tax. Put another way, since different sectors vary in their suitability as tax bases, so their inclusion in an equation attempting to measure taxable capacity automatically includes the role of 'willingness' factors as well (Bird, 1978:253). The result could be that a sector which appears in a regression study as an indicator of taxable capacity, may in reality only be a measure of the 'willingness' to tax that sector more excessively than others.

Thirdly, despite strong statistical support for Hinrichs' hypothesis, the continued use of it in studies has been severely criticized. Tanzi and McCuistion (1967) for example, show that the strong relationship that Hinrichs found was due to the inclusion of the poorest countries in the sample and that the same results are not forthcoming in tests done separately for each of the two major groups. Ali (1974) and Mann (1980) also

produce divergent results for the Hinrichs hypothesis when they applied it to time series data for the Sudan and Mexico respectively. In addition, this variable itself has often been subject to statistical convenience. Afxentiou (1980:132) argues that either a ratio of imports or exports (or some combination of both) to GNP (or GDP) has been used, depending on which formulation produces the better statistical fit.

Lastly, there is also uncertainty regarding the credibility of data from developing countries on which these studies are based, further reducing the significance of any results and conclusions achieved (Bird, 1978:55).

1.2.2 Tax Structure And Economic Development.

Although a number of writers have considered the extent to which economic development factors affect the nature of the tax structure, few serious attempts have been made to develop a 'general theory' incorporating both these aspects. The two notable exceptions, however, are the contributions of Harley Hinrichs (1966) and Richard Musgrave (1969).

The essential difference between these two works and the studies already reviewed, is that instead of concentrating their attention solely on the tax ratio (which is only a single aspect of tax structure change), Hinrichs and Musgrave attempt to provide an explanation for the changing morphology of the tax system.

Two questions form the basis of their enquiries. Firstly, what changes have taken place in nations tax structures historically over time, and secondly, how can tax structure change be linked

to the process of economic development (Mansfield, 1971:36).

In Hinrichs'(1966) 'general theory', tax structure change is viewed within the broad framework of social mobilization as postulated by the political scientist Deutch (1961). Essentially, two elements are involved:

The first is structural change in the economy. This occurs during the process of social mobilization, a process involving industrialization, specialization, democratization, productivity and income changes. These produce a larger share of taxation for governments, irrespective of the prevailing ideology. (i.e., structural or elasticity factors).

The second is ideological change both over time and during the process of social mobilization itself. This might include attempts to provide a Welfare State, or to secure and develop an existing ideological system (i.e., discretionary factors).

Most importantly though, Hinrichs emphasizes the manner in which tax policy adjusts during this process of social mobilization and economic development, to ensure the efficient financing of expenditure requirements over time. In his own words:

".....the prevailing theme.....is that the process of social mobilization and economic development means necessarily that the types, sizes and rates of growth of economic tax bases (be they land values, foreign trade, output, personal incomes, etc.) change in the course of development, necessitating concomitant changes in tax rates and forms of taxation so that the expenditure-revenue gap over time does not become too great and result in excess inflation and/or political instability."
(Hinrichs, H., 1966, p.33).

Within the framework of 'social benchmarks', Hinrichs further argues that the history of tax structure change can be roughly divided up into a general pattern consisting of five stages.

In the first stage, besides non-tax forms of revenue, subsistence societies rely heavily on 'traditional direct' taxes levied on land, agriculture and livestock. In the second stage, when countries begin the transition to modernity, indirect taxes, particularly customs duties levied in the foreign trade sector emerge as the dominant form of finance. This period is also the one in which traditional forms of taxation fall away, with tax collections dependent on the 'degree of openness' of the economy. By the later second stage or early third stage, traditional direct taxes fall away completely leaving only indirect taxes as the major revenue source. In the fourth stage, corresponding to the period in which most developing countries find themselves today, the importance of internal indirect taxes begins to grow. The reason for this can be found in increased domestic production associated with the process of import substitution, which provides a number of feasible indirect bases for excise and sales taxes. In the fifth stage, corresponding to the period of full maturity in economic development (e.g., U.S.A., Britain), direct taxes on individuals and company incomes finally become the dominant forms of taxation.

Taking a broad view, therefore, Hinrichs concludes that the base for taxation has essentially moved from agriculture, to trade, to consumption and finally to income. As he puts it:

" Looking at tax revenue history in a broad perspective, one may be more than halfway justified in saying that the structural movement has been from taxation on (1) agriculture, to (2) foreign trade, to (3) consumption, to (4) net income, individual and business."
(Hinrichs, H., 1966, p.106).

Hinrichs also found that if one further consolidates these five stages, it is possible to identify three main phases of varying degrees of reliance on indirect and direct taxes. In the early period, direct taxes are singularly important until the emergence of a foreign sector which provides the base for indirect trade taxes. In advanced stages of economic development, modern direct taxes finally predominate. Hinrichs ascribes this latter phenomenon to the fact that that only modern economies have direct tax bases broad enough to be sufficiently elastic to increase their revenue contribution so as to finance rising expenditure demands from general economic growth.

Thorn (1967:27), after an empirical study into the 'evolution of public finances' also came to a similar conclusion. In his sample of some 52 countries, he found that in most cases there is a tendency for the proportion of tax revenues provided by direct taxes to grow, irrespective of whether structural or ad hoc changes in the tax system are chosen to obtain the necessary growth in revenue.

Lastly, Hinrichs also stresses that tax structures in the early stages of economic development remain severely limited to the availability of feasible tax bases. In later stages, however, when the country is either fully or partially mature, the tax structure reflects political and cultural preferences more, due

to the emergence of a number of feasible tax bases, from which policy planners can choose. Thus:

"...for modern societies.....[one may say that the most significant determinant of the tax structure is].....the style set by cultural and/or political factors rather than in transitional society, sheer exploitative might, or in traditional society, the necessities of economic structure and limited abilities on the part of government to mobilize resources through the internal tax mechanism."

(Hinrichs, H., 1966, pp.108 - 109).

Compared to Hinrichs' attempt at a 'general theory', Musgrave's contribution is far less ambitious. Nonetheless, his general approach to the subject is much the same, except for a greater stress on the 'tax handle' theme i.e., the close linking of development in the tax structure to the availability of tax bases, especially during the early stages of economic development. As Musgrave summarizes his view:

" Economic factors bear on tax structure development in two ways. As the structure of the economy changes with economic development the nature of the tax base changes as well, and with it the 'handles' to which the revenue system may be attached. Moreover.....the economic objectives of tax policy vary with the stages of economic development as do the criteria by which a good tax structure is to be judged."

(Musgrave, R., 1969, p.125).

However, unlike Hinrichs, Musgrave tends to see the effects of development on the tax structure as more a function of 'institutional' change, rather than one of economics (as is the case with expenditures). Musgrave also gives more attention to the role of political and social factors:

".....political and social forces must be considered as well. History testifies to a close interaction between changes in the political setting and in tax structure; and standard of tax equity, closely linked with the social philosophy of the time, have always been a major factor in the choice of appropriate tax instruments."
(Musgrave, R., 1969, p.132).

Musgrave thus views tax structure change as a function of two factors. Firstly, economic factors which determine the size of different tax bases and the availability of tax 'handles', and secondly, political and social factors, which influence ideas about tax equity and fairness.

Musgrave's historical account of the evolution of tax structures is similarly divided into 'early' and 'later' periods.

In the 'early' stages of economic development, with the predominance of agriculture, land taxes and other forms of 'traditional' taxation are the most common forms of government revenue, although selected excise revenues may also play a role. On the other hand, income taxes on individuals and companies are seldom in force unless foreign businesses are present, or in situations in which a large government bureaucracy exists. As in Hinrichs' account, the most effective tax 'handles' at this stage of a country's economic development are customs and excise duties.

In the 'later' period of economic development, characterized by higher levels of per capita income, political and social considerations play a greater role, due to the emergence of a wide range of tax bases and 'handles.' Policy options expand and the emphasis shifts away from finding feasible tax bases, to one

of devising high yielding taxes and ensuring effective collection. As Musgrave puts it:

" If the availability of tax handles places a constraint on total expenditures in low income countries, it may be expected to do so even more with regard to the tax structure mix. This constraint again loosens as per capita income rises and in high income countries, the composition of revenue structures become a free policy choice." (Musgrave, R., 1969, p.147).

Thus, the basic conclusions of both Hinrichs and Musgrave are much the same. In the early stages of a country's development, there is a close relationship between the tax structure and the stage of economic development reached, due to the shortage of available tax bases and 'handles'. In later stages, economic factors play a less dominant role and tax structures become more a reflection of cultural and political choice.⁸

1.2.3 The Costs of Collection

Another similarity in the two studies outlined above, is the role that the costs of collection (Hinrichs' - 'ease of collection') play in the determination of tax policy decisions. The basic rationale for this argument is that governments aim to minimize the costs of collecting taxes, by selecting tax bases and tax instruments that facilitate easy levy and collection.

This approach to taxation, implicit in early tax policy (Hood, 1983:45), has recently been extended in the literature to the point where it is argued that ultimately it is the costs of collection which determine tax structure evolution. Thus, as Alt states:

"The major trend toward the taxation of business and indeed the use of businesses as collection agents, suggests that the costs of collection determine tax system evolution." (Alt, J., 1983, p.205).

Alt (1983) develops a model of tax structure change in which he argues that governments attempt to maximize their revenue collections, net of the costs of collection (at the margin), by 'farming out' the task (and hence the cost) of collecting taxes.

Simply, if net collection $N(C)$ equal gross collections $G(C)$ less administrative costs $A(C)$, then tax collectors will attempt to maximize $N(C)$ by 'farming out' administration costs $A(C)$ to the private sector. In practice, this involves a process of converting administrative costs into compliance costs through legislative action designed to relocate the source of collection to a point in the private sector. A good example of this would be PAYE, where the private sector is burdened with the financial costs of calculating, collecting, and returning personal income tax.

This 'farming out' or shifting of administrative costs to the private sector, does however have a concomitant loss in gross revenues ($G(C)$): higher compliance costs in the private sector raises the effective tax bill of firms and individuals. This undoubtedly leads to increased tax resistance, manifested in increased tax avoidance, tax evasion and growth in grey market activities. These factors thus act to reduce $G(C)$ and ultimately $N(C)$. There exists, therefore a trade-off between falling administrative costs (which raise $N(C)$) and increased resistance to this, which raises compliance costs (ultimately reducing

N(C)). The equilibrium situation which emerges when tax collection costs are 'farmed out' to the private sector, is thus at the point where the savings in administration costs just equal the loss in revenue caused by increased compliance costs. This can be represented graphically in Fig. (1.1) below.

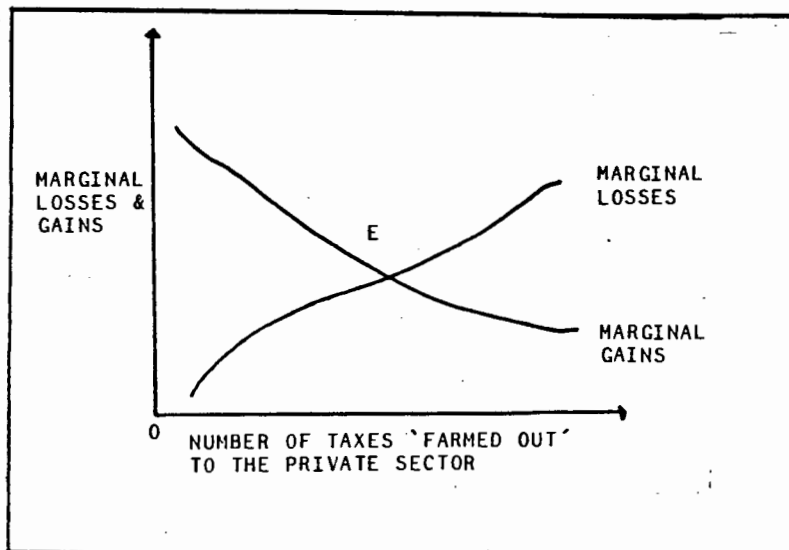


FIGURE 1.1 MARGINAL GAINS AND LOSSES IN THE TAX 'FARMING' PROCESS.

As can be seen from Figure 1.1 above, taxes will continue to be 'farmed out' to point E, where the marginal losses caused by increased compliance costs, through evasion and avoidance, just equals the marginal gains associated with reduced administrative costs created by the 'farming out' process.

Ward (1982) extends this analysis a step further and sees the fall in the cost of collecting taxes as the principal determinant in the growth of tax receipts. In fact, according to Ward,

collection costs are '.....the single most important variable influencing government's size' (Ward, 1982:348).

According to Ward, there are basically four main reasons which can account for the fall in the costs of collecting taxes. Briefly they are:

1. Consolidation in the number of sources from which taxes are collected.
2. Increase in the revenue per source.
3. Increased 'costs' associated with tax evasion.
4. A reduction in the cost of extraction per source.

The first of these factors is associated with increasing economies of scale, the second with general economic prosperity, the third with what Ward calls 'increasing interdependence among society's tax paying agents', and the fourth as a result of improved accounting techniques and methods.

According to Ward, collection costs are so relevant to the whole debate that the history of income tax, and to a lesser extent, the history of commodity taxation, can be fully explained within a falling costs of collection paradigm.

Lastly, using a slightly different approach, Kau and Rubin (1981:262) argue that the growth of government has resulted from a 'technological change which has led to a reduction in the cost of collecting tax revenues'. Approaching the issue from the supply side, they do not argue specifically that there has been a technological change in the method of collecting taxes, but rather that changes in production technology have indirectly led

to an increase in the proportion of income subject to taxation. Changes in technology, relating to the specialization and division of labour, economies of scale, increased market productivity and urbanization are cited as the major reasons responsible for reducing the possibility of successful tax avoidance. In short, the point Kau and Rubin stress is that changes in technology have 'led to forms of organization and behaviour' which have made taxation easier for tax collectors through reduced collection costs.

1.3 The Public Choice Approach

In the previous section, it was contended that with economic development, a wide range of feasible tax bases would emerge and with them tax 'handles' to which the revenue system could attach itself. Given the increased availability of these bases and 'handles', it was proposed that the tax structure in later stages of economic development would increasingly reflect political choice.

In this approach, we continue with this latter theme and introduce political considerations into the discussion, primarily within a framework of positive public choice.⁹ The advantage of public choice theory to the economist, is that it uses economic tools to explain political institutions and decision making, enabling one to create an economic framework in which it is possible to understand political phenomena (Mueller 1979:1). And, although there is not much overlap between public finance and public choice (Mueller, 1979:4), it provides the apparatus required to understand decisions taken by politicians and voters about taxes. This is crucially important since:

".....the level and composition of government revenue result in the first instance, from decisions by government about what revenue sources to use (and to what extent) and from the decisions and actions of tax-paying entities. Any satisfactory explanations of the level and composition of government revenues must be based on satisfactory theories on how relevant decisions are made."
(Larkey, P., et al, 1981, p.192).

In the first part of this section, we analyse the concept of taxation in a representative democracy as developed by Downs

(1957, 1960). Thereafter, the approach is extended to include a number of post-Downsian extentions and alternate views forwarded by among other; Breton (1974) Pommerenhe and Schneider (1983), Bartlett (1975) and Hettich and Winer (1984). Also included is an examination of the important fiscal illusion concept, a look at the role of special interest groups and redistribution.

1.3.1 Taxation in a Democracy

Possibly the best known economic theory which attempts to account for the process of taxation in democracies is that developed by Anthony Downs (1957, 1960). Essentially an attempt to use economic tools to understand government decision making, Downs' model emphasizes the similarities in the way in which political and economic markets operate. It has also provided the basic conceptual framework around which most literature in this field has developed (Mueller, 1976:408).

The basic rationale of Downs' approach is that just as competition in the economic sphere guides producers to supply in line with the preferences of consumers, so to in the political sphere, politicians compete for office in accordance with the desires of the electorate. Consequently, politicians do not decide issues, but simply respond to those needs of the electorate necessary to ensure election or re-election. As Downs puts it:

" The fundamental hypothesis.....(is that)...parties formulate policies to win elections, rather than win elections to formulate policies."
(Downs, A., 1957, p.28).

The process of taxation in Downs' model, is set within a fundamental paradigm in which taxes are viewed as burdens and expenditures as benefits. Taxpayers pay taxes individually and feel the costs directly, yet receive benefits collectively, these being usually indivisible and non-exclusive.

In Downs' model, the lack of a direct link between taxation and expenditures, ultimately leads to an asymmetry problem in which individuals feel as if they are shouldering a larger share of the total tax 'burden'. This is especially the case in circumstances in which benefits accrue in the long run, in large scale redistributive programmes, or not at all. As a result, taxpayers (voters) remain tax averse. That is to say, in an election situation in which all parties propose identical policy 'packages', save for the tax policy, rational utility maximizing individuals will always prefer lower taxes and higher expenditures (as perceived individually), and will support the party which advocates them.¹⁰

The other principal actor in Downs' model, is the politician or political party. Their primary aim is to be elected (or re-elected) into office in order to receive the benefits which accrue to elected officials. To achieve this, politicians gear their tax and expenditure policies to ensure they receive the maximum number of votes at elections. In other words, 'vote-maximizing' politicians formulate tax policy at the margin, by trading votes gained by additional expenditure against votes lost through the raising of taxes needed to finance it. Thus:

" Because the government.....wishes to maximise political support, it carries out those acts of financing which lose the fewest votes.....expenditures are increased up until the vote gains of the marginal dollar spent equals the vote loss of the marginal dollar financed."
(Downs, A., 1957, p.52).

In practice, this approach to taxation means formulating a tax policy which appeals to the so-called 'median' voter, i.e., the individual located at the midpoint of any distribution of preferences. This approach is thus consistent with the earlier Wicksellian tradition (see Musgrave and Peacock, 1958) in which the median voter is assumed to determine the actions of the political machine so as to produce results which are roughly reflective of the preferences of the majority of the electorate.

To sum up therefore - the central theme that can be drawn from Downs' model is that the prevailing tax structure, and any subsequent changes in it, are a direct result of tax policy instituted by a democratically elected government acting in accordance with the preferences of the majority of the electorate.¹¹

Theoretical work done on the median voter model in this regard has mostly been applied in an attempt to explain government expenditure patterns. Using multiple regression analysis, these studies, incorporating explanatory variables such as per capita income and distribution of income, have achieved fairly successful results (Inman, 1978). Unfortunately, only one study of this type (Sjoquist, 1981) has been directed at trying to explain the composition of revenues, despite this having been the originally suggested framework (Flowers, 1977). Empirical

testing of this particular aspect of public choice analysis is thus still in its infancy.

In his 1981 study, Sjoquist tested the extent to which the composition of revenues in local governments in the U.S.A. would vary according to the exportability of taxes, the mean income level of the community, the distribution of income and the income of the median voter. From his results, Sjoquist found support for the median voter rule. In his own words:

".....(whilst).....no-one has attempted to explain the variation in the composition of taxes. To find.....the composition of taxes appears to respond to the same political and economic forces as expenditure is indicative of the utility of the median voter model."
(Sjoquist, D., 1981, p.263).

In an earlier work based on both revenue and expenditure patterns, Niskanen (1979) analysed the effect of economic and fiscal policy on the popular vote for the period 1896 to 1972. Consistent with the median voter rule, Niskanen found that generally speaking, American voters have rewarded the incumbent party for keeping a hold on spending and taxation, but have punished those responsible for increasing the size of the budget.

This kind of empirical support for the median voter rule, coupled together with the mass of median voter rule evidence derived from studies done on the expenditure side (Inman, 1978), has not, however, eliminated the criticisms which have been raised against it on a purely conceptual level.

Firstly, Downs' model relies crucially on the pivotal role of the median voter/taxpayer as the key discriminator in government's

decisions about taxation and expenditure policies. This reliance is, however, clearly a gross over-simplification of the real world. As Forte and Peacock note:

".....the strategies of political parties, in capturing votes, may have to become more complex than the median voter theorem suggests. The problem is that classes lose their sharply defined features, the distribution of votes over the political system becomes more complex, and capturing median votes does not simply mean searching out the middle income taxpayer as the theory suggests."

(Forte, F. and Peacock, A., 1981, p.17).

Similar points are made by Deacon (1979), Schlesinger (1975) and in particular Romer & Rosenthal (1979), who in a review of median voter studies do not find much support for the Downsian hypothesis. Riker (1962), also criticizes Downs' model on the premise that political parties might seek to organize winning co-alitions of minimal size, rather than simply aim at maximizing votes.

Secondly, Downs' model is essentially a static approach to analysing decisions taken by politicians and voters at election times. Consequently, it is really only a theory of budget policy at election times, and, as such, it cannot be expected to 'explain historical change' over time, or even to successfully account for modern day trends (Hansen, 1983:37).

Thirdly, Downs' model assumes that because of the election constraint, politicians are highly pressurised by the electorate into producing tax and expenditure policies that are reflective of the electorate's needs, in order to ensure re-election. The implication of this is that politicians cannot at any time pursue their own, or ideological goals.

This is the central criticism of Breton (1974) and is discussed separately below:

1.3.2 Alternate Views and Extentions

Unlike Downs, Breton refuses to support the notion that voters 'get what they want' in democracies (Hansen, 1983:37). Rather, he maintains that representative institutions have the effect of 'shielding' politicians and political parties from the pressures and demands of the electorate due to the existence of three 'shields'; the electoral period, 'full line' supply, and decision rules regarding the election of candidates.

i) The Length of Time Between Elections

Breton's 'length of time between elections' hypothesis essentially rests on the premise that since individuals forget facts over time, politicians are given added scope to introduce unpopular policies. Put another way, depending on the time still to elapse until the next election, politicians can capitalise on the probability that, with time, the electorate will forget politically unpopular policy innovations such as the introduction of new taxes and the raising of rates. In this way, politicians are able to minimize (maximize) electoral loss (support) associated with different tax initiatives. As Breton puts it:

" election periods of non-zero length, automatically provides politicians and political parties with some freedom to implement policies, which may be at variance with the preferences of some or even all citizens, and at no cost to themselves."

(Breton, A., 1974, p.49).

The election period 'safety' hypothesis has been tested by Mikesell (1978) for the experience of American states over the period 1960 to 1977. Briefly, Mikesell argued that with an electorate that forgets (or forgives), the probability (T) of a new tax being introduced (or that the rates of existing taxes will be raised) in an electoral cycle of four years will be ordered in the following range:-

$$T_{t-4} > T_{t-3} > T_{t-2} > T_{t-1}$$

Very simply, the year after an election is the most favourable time for negative tax announcements, and the year prior to an election, the least favourable. The years between these follow an ordered range. Similarly, the reverse pattern holds true for any tax relief initiatives such as tax abolitions and tax rate reductions.

The results achieved led Micksell to claim that the 'electoral tax cycle' strongly shapes the pattern of United States state tax rate increases.

Mikesell's approach, in addition to building on the contribution of Breton, also relied to an extent on the political business cycle hypothesis expounded by Nordhaus (1974) and MacRae (1977). Although developed in a much broader sense, the same three fundamental assumptions apply: Firstly, governments are vote-maximizers whose primary aim is to win elections (re-election). Secondly, voters are essentially myopic and have preferences that are reflected in their voting decisions.

Thirdly, governments are capable and willing to use the mix of monetary and fiscal policies at their disposal, to improve their chances of re-election by manipulating the short-run state of the economy. Nordhaus (1974) in fact goes as far as to claim that:

".....within an incumbent's term in office, there is a predictable pattern of policy, starting with relative austerity in early years and ending with the potlatch right before the election."
(Nordhaus, W., 1974, p.167).

ii) 'Full Line Supply'

A second shield which 'protects' politicians is what Breton calls 'full-line supply'. The basic idea in this concept is that voters do not vote specifically on separate issues, but are rather confronted with 'bundles of policies or bundles of changes in policies' and vote on these (Breton, 1974:50). As a result, politicians are able to supply a number of policies (including say a tax policy) which are at variance with the preferences of some of the electorate, including voters who generally support them.

The rationale is as follows: a government may decide to introduce a tax policy change (e.g., raise taxes), which would ordinarily result in the loss of electoral support. However, this loss can be effectively avoided if the party offers the same group of aggrieved taxpayers other policies (which more than accommodates for the negative effect of increased taxes), in a total 'package' of policies on which the vote is decided. In this way, it becomes possible for the party (politician) to pursue both its ideological and re-election objectives together.

Extending this argument, it is only realistic to recognise that in the mass of policies which characterize political platforms, taxation may not be the only issue, or in fact may not be an argument at all in voters decisions about whether to support a particular candidate or not. Taxation may in fact take a back seat role to other more controversial election issues such as defence and ideology (e.g., apartheid). In short, unlike Downs' model, tax in Breton's view is only one of a large number of variables which influence voting decisions, and, therefore, only one of the factors that political parties take into account when drawing up political programs.

iii) Decision Rules Regarding The Election Of Candidates

A third shield mentioned by Breton, relates to the effect that decision rules have on the election of government representatives in constituencies consisting of different sizes. Gerrymandering, or the manipulation of constituency boundaries, may often result in a situation in which less than a majority of voters are needed in order to control the legislature. That is to say, in electorates composed of constituencies of different sizes, political parties may be able to ignore the preference of larger constituencies in favour of smaller constituencies (in sufficient number) to ensure a majority of seats. This, however, would not also necessarily imply a majority of votes.

Clearly, then, the point that Breton makes is that even in a democracy in which taxation becomes the election issue, the existence of different size constituencies could well result in a

tax policy which does not reflect the desires of the majority of voters preferences, but rather the preferences of those constituencies (in sufficient number of course) from which the government derives the backbone of its electoral support.

A further notable extension into the post-Downsian analysis is provided by Pommerehne and Schneider (1983). Building on the approaches of Downs (1960), Frey and Lau (1968) and Breton (1974), they develop a model of monopolistic government behaviour in which governments attempt to maximize their own utility (subject to the election constraint), by pursuing certain ideological goals.

The basic argument runs as follows: if the governing party feels that its current popularity is high, or if there is still a long time until the next election, it will use the various policy instruments at its disposal to pursue its own ideological goals. This may imply a reliance on higher taxation, smaller welfare programmes, etc., depending on the government's inherent ideological predisposition. On the other hand, if the governing party feels that its chances of re-election are low, or if an election is imminent, the government will introduce policies to ensure its re-election. These might include policies involving increased wealth or income redistribution, lower taxes, or bigger deficits, depending upon the governments vote-maximizing function. The gist of their approach, therefore, suggests that political parties have well defined preferences for particular tax and expenditure instruments, which they will use for either redistributive or ideological goals, depending on their perception of their their re-election chances.

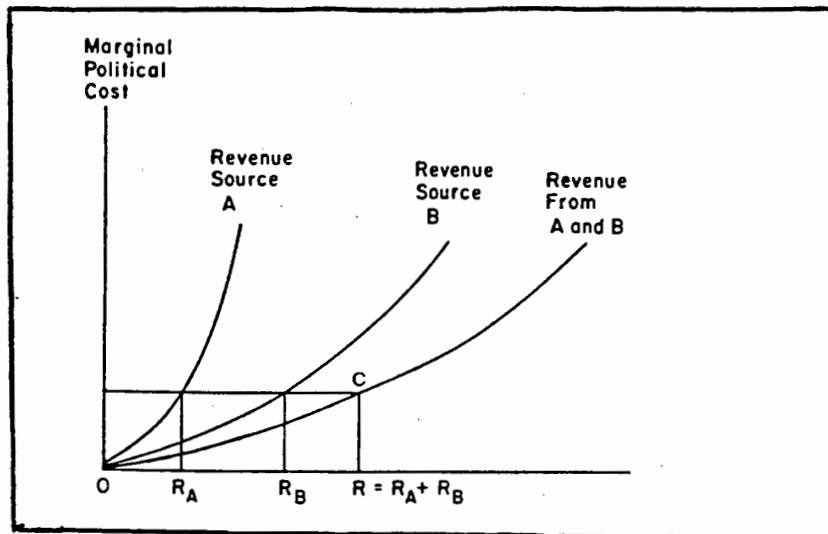
Thus, Pommerehne and Schneider's analysis predicts that the likelihood of government having to act under extreme pressure from the electorate, is remote, except possibly during the pre-election phase. Indeed, after their analysis of the Australian experience they came to the conclusion that:

".....a government undertakes a policy meeting the preferences of the majority of voters, only when it is under strong pressure to secure re-election. There is much less empirical support for a government acting along Downsian lines, i.e.,.....in which the government is permanently under re-election pressure and will thus always use its fiscal instruments in accordance with the preferences of the majority of voters."
(Pommerehne, S. & Schneider, F., 1983, p.82).

Hettich and Winer's (1984) model is a further contribution to the analysis. Comprising the first attempt to develop a truly 'positive' model of tax structures, they propose a theory in which the composition of revenues and the structure of specific taxes evolves 'naturally' as a result of constrained maximizing behaviour on the part of politicians. Here, unlike the Downsian median-voter-driven model, the structure of taxation is determined completely endogenously by public decision makers (politicians), in response to changes in political constraints.

Basically, Hettich and Winer argue that governments will attempt to minimize the political costs associated with raising a given amount of revenue. In practice, this means adjusting the schedule of tax rates and manipulating the structure of taxes, up to the point where the marginal political cost (votes lost) of raising an additional dollar of revenue is equal for all tax sources.

This argument can also be presented graphically for two tax sources, in which the burden of each tax used is borne by different groups of unrelated taxpayers (See Figure 1.2 below):



Source: Hettich and Winer (1984:70)

FIGURE 1.2 MINIMIZING THE POLITICAL COSTS OF REVENUE COLLECTION

From the figure, it can be seen that an equilibrium level C will be reached at a point where the marginal cost of raising an additional Rand from each tax source is the same for both tax A and tax B.

However, because the authors recognise the impossibility of accurately quantifying political costs, the remainder of their analysis is restricted to generating five hypotheses (constraints) which they claim account for the factors most likely to affect government decision-making through their effects on political costs. Briefly, these are:

1. That since the opposition to a tax depends on the effective (and not nominal) tax prices, government will make available to groups of taxpayers most likely to offer political opposition, opportunities to lower their effective tax rates.
2. That the more intensely a particular tax is used,

the greater is the chance that political opposition to further use of that tax will arise (i.e., a limiting constraint).

3. That the more intensely a particular tax base is exploited, the greater is the chance that organised opposition will react to use of that tax base (i.e., a constraint).
4. That the level of taxation in neighbouring states or countries serves as a constraint to a governing party's desired tax structures.
5. That governments will attempt to rely on tax bases that have a low degree of variability, since revenue fluctuations and consequent changes in tax policy to accommodate such fluctuations, are politically damaging for governments.

In short, their final conclusion suggests that, unlike the median voter model, those groups who are relatively insensitive politically to increases in tax rates will bear the disproportionate 'burden' of these raises. On the other hand, sensitive groups will escape with relatively light tax bills. Ultimately, the tax structure in which political costs are minimized will be determined by the political sensitivities of many different groups of taxpayers to changes in the tax system.

Bartlett (1975:117), in his positive approach, develops similar themes to Hettich and Winer's regarding individuals, but at the same time, gives greater attention to the taxation of the producing sector.

According to Bartlett, the vote-maximizing politician shifts a large share of the burden onto the producing sector, since 'producers as such do not vote.' Moreover, voters are made aware of this policy with what Bartlett calls 'subsidised information'. In the long run, however, the effective burden on the producing sector is a lot less since higher taxes invariably become higher

prices. Simply, producers are taxed, but the consumer bears the burden.

Bartlett concedes, however, that producers are able to exert influence on government. The schedule of the tax rates and instruments actually applied will thus vary with government's sensitivity to these pressures. In the final analysis, therefore, the result will be a system of differential taxes for different industries, within the producing sector itself.

1.3.3 Redistribution

The public choice approach argues (consistent with normative theory) that the tax system is redistributive in nature, with a bias in favour of those classes in the middle income range. That is to say, since the middle income groups invariably determine the actions of government because of their key role in the electorate, one might naturally expect the various tax and expenditure instruments in force to reflect their preferences.

This argument is probably best developed and tested by Stigler, in his restatement of Directors Law of income redistribution, which claims that:

" Public expenditures are made for the primary benefit of the middle classes, and financed with taxes which are borne in considerable part by the poor and rich."
(Stigler, G., 1970, p.1).

However, as is the case with many other studies which have attempted to measure the distribution of the tax burden, the results of empirical tests which have examined this and related

hypotheses, have been very mixed, and have always remained dependant upon the (debatable) incidence assumptions used (see McGrath, 1979). Thus, while Sahota's (1978:29) survey finds that most statistical studies indicate 'a redistribution from upper income classes to lower income classes', others disagree. Pechmans (1974:10) influential study, for example, claims that the U.S. tax system is essentially proportional for the vast majority of families and therefore has 'little effect on the distribution of income'. And, taking even a broader view, Saunders (1984) concludes that for most countries the tax system has 'almost no effect on income redistribution'.

In addition to these empirical contradictions, the assumed direction of redistribution in Stigler's hypothesis, has also been attacked on purely conceptual grounds.

Stack (1979) for example, argues that given the fulfilment of a number of conditions, political forces will tend to nurture and maintain a tax structure that is effectively progressive, i.e., one in which there is considerable amount of redistribution to the poor. Marxist writers on the other hand tend to see redistribution at the expense of labour in favour of the dominant capitalist class (see; O'Connor, 1973; 1974, Hunt and Sherman, 1972:145).

In essence, the whole question centres around the extent to which different groups or coalitions can organize themselves in the government. Those groups that are able to control the government legislative machinery will use it to improve their position vis á vis the fisc (Stigler, 1970). Thus, if the rich

are in the majority, it is only realistic to expect that they will couple expenditure requirements with a regressive tax policy on the poor and vice versa. Indeed, even under simple majority rule it is theoretically possible for 51% of the electorate to enforce legislation to ensure that 49% of the electorate pay the full tax bill (Tullock, 1959).

1.3.4 Fiscal Illusion

A number of public choice theorists have argued that since the cost-benefit calculus in the public choice paradigm plays a crucial role in voting decisions, vote-maximizing politicians will attempt to develop tax structures that reduce the individuals' perceived tax burden by relying on fiscal illusion techniques. This is of course not altogether surprising since economists have always agreed that the best method of raising a given sum of revenue is to use a tax system which causes the least amount of inconvenience and subjective cost to taxpayers.

In practice, attempts to integrate fiscal illusion into the system means selecting tax instruments and manipulating tax rates so as to reduce the visibility and hence the perceived tax burden of individual tax bills. As Alt states:

".....tax policy is.....a matter of inducing taxpayers to pay more than they would otherwise might wish to pay. Taxation remains a bad and so the best thing a politician can do is to keep the decision out of sight. Any way of distributing tax costs broadly to make them appear less significant will seem politically desirable."
(Alt, J., 1983, p.183).

The idea of fiscal illusion goes back to the early writings of

Amilcare Puviani (1897, 1903). In Puviani's model (see Buchanan, 1967) the State is modelled as a revenue maximizer which attempts to extract as much revenue as possible from the 'ruled' classes, by relying on a tax structure that produces the least amount of taxpayer resistance.

Since then, the role that fiscal illusion techniques play in the choice of tax instruments and in the manipulation of tax rates has been further explored. One might even be tempted to argue that this has been more the case ever since Buchanan (1967:128) commented that '.....it was surprising that fiscal illusion had not been more thoroughly analysed'.

Hansen (1983) for example, in her analysis of the evolution of tax policy in the United States, bases a large measure of her argument on the notion that politicians have endeavoured to incorporate fiscal illusion devices into the tax system in order to raise discretionary revenues. Indeed, she goes so far as to claim that:

" The technique of 'fiscal illusion' has been developed to a high art.....(we).....describe in detail some of the devices that policy makers have used to deflect the wrath of taxpayers."

(Hansen, B., 1983, p.23).

Visibility of the tax system is essentially the issue in the fiscal illusion literature. It is strongly associated with three tax features; type, timing, and complexity (Pommerehne and Schneider, 1978:384-386). Each of these is discussed separately below.

1. Fiscal illusion in the tax system, due to the types of taxes used.

Tax visibility varies with the mode of assessment and the nature of the taxes used. Individual taxes, for example, are imposed directly and when compared to other taxes, are relatively visible. Other taxes such as GST (inclusive) and excise and customs duties, in which the tax portion is concealed in the price, are generally less visible. Downs (1960:558) in fact argues that indirect taxes are the major forms of tax concealment. Wildavsky's (1975:253) study argues further that European countries which have required high tax collections, have relied heavily on indirect taxes rather than broadly based direct taxes. Maital (1975:63) adds a further twist in suggesting that 'taxpayers....(in the U.S.A.)....have preferred increases in indirect taxes rather than direct taxes'. Buchanan goes further claiming that:

"....fiscal instruments that generate illusions may be chosen by the people. Taxpayers may in fact prefer to fool themselves."
(Buchanan, J., 1977, p.10).

Company tax, although a direct tax, has a low visibility level and is thus also a form of major tax concealment. That is, in a general equilibrium model in which taxes are treated as costs, companies pass higher tax burdens forward in the form of higher prices to purchases, or backwards to reduced returns to factor inputs, in an effort to maintain their required rate of return. In this form of tax 'shifting', it is highly unlikely that voters/consumers are able to identify rising prices with rising real tax burdens.

Fiscal drag is also crucial. Inflation induced rising nominal

incomes force taxpayers into higher tax brackets which results in higher real tax burdens. The gist of this argument is that if rates can be raised without deliberate legislative action, taxpayer tax consciousness and subjective burdens will be minimized by utilizing non-indexed progressive tax instruments (Goetz, 1977:182).

2. Fiscal illusion due to the timing of the tax assessment.

It has also been argued, that the more often tax is paid, the less likely it is that an individual will be aware of his total tax burden (Goetz, 1977). This notion, which relies on the 'law of small numbers', argues that if a large tax burden can be divided up into a number of small payments, then the total amount of tax paid will appear less burdensome to taxpayers.

For example, individual income tax can have its perceived burden substantially reduced if the tax is paid monthly in the form of a withholding scheme such as PAYE. Goetz contends that since an individual never receives the income in the first place, he/she is less likely to feel the brunt of its monthly deduction. Von Wagstaff (1965) examination of the situation partially confirmed this hypothesis, when his sample found very few taxpayers who could accurately determine the amount of income tax that they had paid in any full tax year.

A similar argument can be extended to account for the illusionary effect of deficit and debt financing. Debt which is a product of deficit financing, is really only postponed taxation, and is, therefore, less likely to be capitalised into an

individual's present day perception of the total tax bill. Buchanan and Wagner (1977:69) thus claim that borrowing and money creation reduces the perceived price of publicly provided goods and services with the result that governments will tend to opt for less visible deficit spending whenever possible.

3. Fiscal illusion due to the complexity of the tax system.

A third reason for reduced visibility centres on the complexity of the tax system itself. This notion contends that the more complex the tax structure, the less likely it is that an individual will be able (or willing) to ascertain his/her true tax burden.

Wagner (1976), who wrote the seminal work, argues that 'complex tax systems hide the total tax burden' and that the impact of fiscal illusion is likely to become more substantial with increases in tax system complexity. The same point is reiterated in his (and Buchanan's) later more complete work:

".....complex and indirect payment structures create a fiscal illusion that will systematically provide higher levels of public outlay than those that would be observed under simple payment structures. Budgets will be related directly to the complexity and indirectness of tax systems."
(Buchanan, J. and Wagner, R., 1977, p.129).

Wagner (1976) originally found support for the idea by discovering an inverse relationship between the level of local government expenditure and the degree of concentration of the tax system on a few (visible) tax sources. In other words, the more complex the tax system, the greater the level of tax expenditures

possible.

The fiscal illusion literature is not without its critics:-

Firstly, it ignores the learning process that individuals undergo over time. The old adage that 'one can only fool some of the people some of the time' implies that in the long run, there will be increased resistance to the use of such methods (see Forte and Peacock, 1981:16).

Thus, in a test of the fiscal illusion hypothesis, Cameron (1978:1251) finds no evidence for its applicability as a determinant of tax levels. Rather, he argues that a high and increasing use of fiscally illusory taxes actually results in a fall in tax revenues. Furthermore, according to his study, those countries which have relied most heavily on wealth-elastic, and therefore highly visible taxes (e.g., personal and company income tax), have experienced the greatest tax revenue growth.

Secondly, the bias which is towards the under-estimation of the tax bill is generally assumed. This ignores the possibility that the bias may have the opposite tendency i.e., lead to an over-estimation of the tax bill (see Pommerehne and Schneider, 1978:386).

Thirdly, the exclusion of expenditure considerations from most empirical examinations of the fiscal illusion hypothesis may be guilty of considering only half of the total picture. Musgrave and Musgrave point out that:

".....fiscal illusion exists, but.....the argument has two sides. While taxpayers may under-estimate their burdens they may also under-estimate expenditure benefits."
(Musgrave R. and Musgrave P., 1985, p.119).

1.3.5 Special Interest Groups

The traditional account of tax structure change in democracies emphasizes the important role that special interest groups play in the determination of tax policy (see Herring, 1938). This notion, which has its origins in the early classical writings of Smith and Ricardo, arises out of what Fusfeld (1982) calls the 'conflict of interests' that characterises all tax systems: since governments require revenue and individuals generally do not like paying taxes, the latter will as far as possible attempt to reduce their effective tax bill. In the final analysis, this amounts to the shifting of the tax burden onto others. The farmer will want the business sector to pay the tax, the rich would rather tax the poor (and vice versa), the business sector the consumer, and so on. In fact, according to Alt:

"....one cannot read the history of taxation without being struck by how common the theme was of shifting the tax burden onto someone else."
(Alt, J., 1983, p.194).

The formation of special interest groups is the principal method by which certain individuals in society have secured the necessary legislation needed to reduce their own tax bill. Indeed, the very existence of special interest groups is predicated by their ability to successfully promote member demands through the political process. Put more formally, a special interest group maximizes the utility of its members by

obtaining the necessary legislation needed to reduce their tax bills, subject to the constraints imposed by the activities of other special interest groups and government. And, although few studies have directed their attention here, the evidence which is available suggests that this has been done very successfully in most Western Democracies (see e.g., Schneider and Naumann, 1982).

The extent to which these groups maintain their success of course depends on their negotiation skills, and most importantly, on the amount of pressure that they are able to bring to bear on government as representatives of economic interests and particular voting groups. Simply, as Mueller and Murrell (1986:126) argue, interest groups attempt to 'win favour for their membership by offering to supply a party with votes'. It is government then that exaggerates the disparity in tax burdens across groups by providing a range of tax allowances and 'breaks' for those voters crucial to their vote-maximizing function. As Head and Bird argue:

"...underdemocratic decision-making the tax system will always to some extent be manipulated by the government of the day to serve the economic interests and ideologies of its members and supporters."
(Head, J. and Bird, R., 1983, p.5).

Buchanan and Tullock's (1962) analysis takes a different angle. They contend that the emergence of special interest groups arises as a result of the successful lobbying activities of a single group. This gives incentives to other groups to follow suit, only ending when all groups are fully organised. They argue that in a situation in which government provide general benefits financed out of general tax revenues, there is little incentive for individuals to organise themselves, until one group

does, setting a precedent for all. In their own words:

" Suppose..(the)..institutional 'equilibrium' is disturbed through the efforts of one.....interest group.....successful in(securing)...legislation which provides the group....with special benefits.....not applied generally to the whole population....(e.g...differential tax privileges)...other interest groups observing the success of the first, will.....invest resources.....in political organisation. The pressure group as such will become a part of the political decision-making process.the process will continue. The ultimate 'equilibrium' will be reached only when all groups have become fully organised."
(Buchanan J. and Tullock G., 1962, p.287).

The end result of this chain reaction implies that ultimately the structure of taxation will reflect the relative strengths of different interest groups. Those groups which can muster the most political influence will thus be able to reduce their fiscal obligations. Those with the least will bear the brunt of taxes. Moreover, not only does successful special interest group action create an awareness among other groups to follow, but it also literally forces them to follow suite. This is because lower tax bills for some, implies higher tax bills for others, forcing the latter to proceed with similar action in order to maintain constant after tax incomes. Thus, as Olson (1965) in his seminal contribution on groups argues, rational self-interested individuals will not engage in any collective action unless there is some coercion that leads them to act in their common interests. Moreover, organisational costs will play a crucial role in keeping groups at their optimal size.

The actual dynamics through which special interest groups obtain these concessions or 'tax breaks' has also been fairly

well discussed. For example, in Forte and Peacock's (1981) schematic treatment (reproduced in Table 1.1 below), it is clearly evident how the whole process can be expected to take place. Interests groups (e.g., companies, workers etc.), acting through a variety of agents (lawyers, unions), and using various modes of action (legal and illegal), might influence decision makers (legislature, courts) into initiating tax structure changes that benefit the group concerned.

(1) <i>Interest group</i>	(2) <i>Agent</i>	(3) <i>Mode of action</i>	(4) <i>Decision-takers</i>	(5) <i>Tax structure changes</i>	
				<i>Tax</i>	<i>Conventional incidence assumptions</i>
<i>Personal</i> (1) Working (i) Skilled (ii) Unskilled (2) Non-working population (i) Retired (ii) Physically/mentally impaired (3) Self-employed <i>Corporate</i> (1) Private sector companies (i) Corporate (ii) Non-corporate (2) Public sector companies (3) International companies	<i>'DIY'</i> <i>Professional consultants</i> (e.g. lawyers, accountants, economists) <i>Trade unions</i> <i>Trade associations</i>	<i>Legal</i> (1) Tax avoidance (2) Tax amendment <i>Illegal</i> (1) 'Overt' tax evasion (2) 'Covert' tax evasion	<i>Legislatures</i> (1) Central (2) State/Local <i>Public servants</i> (1) Central (i) Tax authorities (ii) Other (2) State/local (i) Tax authorities (ii) Other <i>Courts</i> <i>Supranational organizations</i>	<i>Personal income tax</i> <i>Corporation income tax</i> <i>Estate and gift taxes</i> <i>Excises and sales taxes</i> <i>Property tax</i> (1) Residences (2) Rented property (3) Business premises <i>Payroll taxes.</i> (1) Employer (2) Employee <i>Licences and fees</i>	Income-tax payer Consumers, investors Donors Consumers Home-owners Tenants Consumers, investors in property Consumers Employees The payer

Source: Forte and Peacock (1981:7)

TABLE 1.1 SPECIAL INTEREST GROUPS AND TAX STRUCTURE CHANGE.

Most importantly though, in addition to clearly identifying the major participatory groups and dynamics involved, Forte and Peacock's schematic treatment also identifies the fact that the groups who benefit from the conventional incidence assumptions (i.e., as a result of successful special interest group action) may often bear only a remote resemblance to the groups who

initiated the action in the first place (column one). That is, because of the uncertainty surrounding tax incidence, agents (column 2) may promote (mistakenly or otherwise) their client's case according to how the former perceive their client's tax burden to be, rather than according to what it really is. In this way, successful special interest group action may often do little to improve the tax position of the group concerned, even though they may believe this to be the case.¹²

1.4 The Marxist Approach

In the previous section, we investigated the public choice approach to analysing tax structure change. Briefly, it was argued that the tax structure which emerges in a democracy is the result of an interaction between the preferences of both politicians and the electorate. In addition to these two main groups, we also emphasized the important role that special interest groups play in the determination of tax policy.

In this section, we take the latter concept a step further and extend special interest groups into class interests, presenting the marxist approach to the analysis of tax structure change. Of the three major approaches evident in the literature, this approach is the least explored, with notable contributions confined to Goldscheid (1925), O'Connor (1973, 1974) and Kratke (1984). Generally speaking, whilst some Marxist writers have looked at State expenditure (e.g., Gough, 1979; Foley, 1978), very few have examined issues in taxation (see Kratke 1984:99).¹³

Justifying the marxist concern with tax, O'Connor maintains that:

" Tax finance is (and always has been) a form of economic exploitation and thus a problem for class analysis.....every important change in the balance of class and political forces is registered in the tax structure. Put another way, tax systems are simply particular forms of class systems."
(O'Connor, J., 1973, p.203).

The outline of this approach is as follows. In the first section, some basic marxist tax concepts are briefly considered, including; the role of the State, the concept of 'fiscal sociology' and the relevance of 'power'. Thereafter, the marxist

perspective on taxation and class is reviewed. The final section comprises a cursory review of 'fiscal crisis'.

1.4.1 Taxation and the Role of the State

Very briefly, in the classical marxist analysis, there are two main classes, defined in terms of property relations. On the one hand there is the capitalist class which controls the means of production, and on the other hand, the working class, wage-earners or proletariat. Under the marxist schema, the capitalist class exploits the working class by appropriating 'surplus value' (being the manner in which surplus labour is appropriated in capitalism), in the form of capitalist profit, interest and rent. Marxist analysis thus operates on an extremely high level of abstraction viewing the primary economic relationship as one between capital and labour, the nature of which manifests itself in the form of a class conflict.

Above these productive and social relations, yet incorporated into the whole analysis, is the State. According to the classical marxist analysis, the State is subordinate to the interests of the dominant class and is a tool through which this class enforces the system of property relations best suited to its interests. Under capitalism, the capitalist class is dominant and its preferences are clearly the long-run reproduction of the capitalist mode of production. As Sweezy puts it:

"...we should naturally expect that the state power under capitalism would be used first and foremost in the interests of the capitalist class since the state is dedicated to the preservation of the structure of capitalism."

(Sweezy, P., 1942, p.248).

The tax structure, especially tax instruments, reflect these aims. They form part of the total superstructure of socio-economic, political and cultural institutions which pertain to a given stage of economic development. They are also, therefore, a product of both the development of the productive forces and of the system of social relations (Odle, 1977:407).

The perceived role of taxation in the marxist model is thus unlike the role of taxation in contemporary non-marxist analysis. For example, in the latter, the tax ratio is roughly the cost of financing public goods and services provided by the State. In the former, it is the cost of implementing policies that are needed to preserve the existing status quo. Similarly, growth in revenues over time are not simply a feature of economic development and rising expenditure requirements, but are rather indicative of the growing costs incurred by the State in maintaining capitalist rule (see Schmidt, 1982:264).

In the same way, taxable surplus in the marxist model of taxation has its own particular meaning. Closely alligned to the marxist concept of total value, taxable surplus in this schema would roughly correspond to that part of 'total value' 'appropriated' as surplus value. Taxation is not, however, financed out of an existing 'pool' of surplus value. This would imply that prior to taxes all wages were at their true value of labour power, this

surplus being otherwise available to capitalists for accumulation in the event of lower or no taxation. Nor is taxation simply a drain on existing surplus value (Wright, 1978:155). Rather, taxation appropriates surplus that is generally not available for accumulation by capitalists. It is thus in its own way similar to 'economic exploitation' which the State either rationalises through a reliance on established principles of equity, or conceals through the incorporation of fiscal illusion devices (Heald, 1983:268; O' Connor, 1973:294).

Paralleling the fiscal illusion literature, therefore, the marxist approach sees tax 'exploitation' invariably concealed from the taxpayer through a reliance on indirect taxes such as sales tax (inclusive) and excise duties. As will be shown, marxists also argue that much of the tax burden is hidden in corporate taxes such as company, business and property tax, which are passed on to the working class. On the other hand, if more-visible taxes are required, marxists contend that these are invariably served up with slogans such as 'ability to pay' and 'equal treatment for equals' in order to appease the working class and to reduce feelings of discontent. The proletariat, having been socialised and educated to accept this ideology, do not contest this rationale.

Rudolph Goldscheid (1925) was perhaps the earliest marxist writer to analyse the fiscal role of the State in strictly marxist terms. In his analysis, Goldscheid maintains that the only feasible way to analyse changes in expenditure and taxation trends over time, is to adopt a 'sociological' approach. This he does by placing the fiscal process at the heart of State

activity. In his own words:

" Of the three basic pillars, financial sociology is the most important. It can alone show up the part played by the origin and composition of public revenue in the development of society as a whole and thereby in the destiny of nations and individuals alike. It depends upon social structure and upon the internal and external political constellations whether taxes in kind or money taxes are preferable, whether and to what extent indirect or direct, personal taxes or taxes on objects, income and profits, taxes on land, investment, property and death taxes are to be chosen, whether the tax screw should be tightened or relieved, what groups of the population are to bear the heavier or lighter burden, whether more reliance is to be placed on customs and excise or on loans, whether internal or external borrowing is raised, how taxation is to be combined with economic incentives and so on."
(Goldscheid, R., 1925, pp.206 -207).

Using this framework, Goldscheid attempted to interpret the evolution of Austrian fiscal history from the Middle Ages right through to World War One. Throughout, the basic point Goldscheid stresses is that the tax system, and any subsequent changes in it over time, are in the final analysis reflective of changes in the underlying social structure. For Goldscheid, therefore, this means that only with an understanding of the evolution of class relations can one attempt to understand the evolution of the tax system.¹⁴

Very similar points are stressed by Gough (1979) in his analysis. Highlighting the role that class conflicts play in the evolution of tax structures over time, Gough argues that in the real world, tax policy is not fashioned in accordance with principles of equity and fairness, but rather reflects the 'economic and political strength of the contending classes' (Gough, 1979:126).

In an empirical study of Latin American countries, Best (1976) comes to similar conclusions. Finding the composition of taxes observed remarkably similar to the hypothetical preferences of the large landowner class, Best explains how this pattern had emerged out of the successful action of the dominant capitalist class, which had utilised its 'power' to obtain a tax policy reflective of its needs. In his own words:

"...tax size and composition are primarily a reflection of political choice. But choice weighted by power....(where power is defined as the ability of one group of coalition of groups, to intentionally limit the choices of others).....adjustments in tax rates or tax instruments, reflect a change in the underlying distribution of power in society."
(Best, M., 1976, p.66).

Hinrichs, in his attempt at formulating a 'general theory', also uncovered the importance of 'power' relations in the evolution of tax structures. He argues that '..tax systems not only help to allocate political and economic power, but...are themselves a reflection of that allocation' (Hinrichs, 1966:63).

1.4.2 Taxation and Class

In the marxist model, there are basically three ways in which the State can finance its expenditure. Firstly, it could expand State enterprises and absorb their profits. Secondly, it could create new debt. Thirdly, it could finance the budget by relying on tax revenue.

According to O'Connor, the first option is not feasible, since private capital in the economy invariably undertakes all profit-

able ventures itself, with the result that very few opportunities are left open for exploitation by the State. The second option has long term constraints. This leaves the third option open as the only feasible method through which the State can finance its activities and maintain capital's dominant position.

Following this last option, O'Connor carefully distinguishes between 'taxation of the capitalist class' and 'tax exploitation of the working class.'

The capitalist class, according to O'Connor, pays very little tax or no tax at all. Firstly, corporate taxes are passed on in the form of higher prices with the final result being that company income tax is completely borne by consumers. (Or alternatively 'effective' company tax rates are very low (Woodside, 1982:19)). Similarly, all other forms of business taxation are passed on in part or in full. Secondly, the capitalist class ensures that high nominal personal income tax rates levied on them are transformed into low effective rates. Lastly, O'Connor argues that capitalists are able to accumulate wealth easily since they do not pay (or pay very little) capital gains tax, property tax, inheritance tax, donations or gift tax. In short, tax policy is reflective of capitalist needs and is largely designed around the expansion of private profits and capital accumulation. It is thus not redistributive in favour of the low-income groups (as liberals would argue), but rather serves to preserve the existing status quo. As Eaton puts it:

" All money raised by the State is in effect surplus value, appropriated by the State to maintain capitalist rule ."
(Eaton, J., 1949, p.161).

Hunt and Sherman (1972:289) stress similar points. Focussing on the role of the tax system in the US, they provide empirical evidence to support the view that in American capitalism high income capitalists pay relatively low rates of tax. This they ascribe to; considerable loopholes which reduce high nominal rates into low effective rates, the absence of a realistic capital gains tax, the availability and widespread use of tax free-bonds, low property taxes, and low inheritance taxes.

On the other hand, O'Connor asserts that the working class, small business and monopoly sector workers are less fortunate, and that they bear the full brunt of the tax system. Like consumers in the neo-classical general equilibrium model, they pay all the company tax, sales tax, excise taxes, property tax and so on. Income tax, in particular, is the most exploitative and cannot be avoided at all, especially when collected using withholding schemes such as PAYE. As O'Connor summarises his view:

" Changes in tax rates and the tax structure.... have increasingly favoured corporate profits and growth. And with the tax shelters and loopholes available to monopoly capitalists, the whole system is based, in effect, on the exploitation of the working and small business classes, particularly monopoly sector workers whose taxable incomes are relatively high." (O'Connor, J., 1973, p.208).

Other marxist writers have also stressed this last point. Kratke (1984:99), for example, builds on the marxist labour theory of value and expands the notion of exploitation beyond that developed by O'Connor. He argues that tax exploitation of the working class in terms of the marxist theory of value is more than just inequality of tax burdens and tax benefits. Rather,

tax exploitation for Kratke extends to mean a specific relation of non-equivalence between 'labour spent by people on behalf of the tax state and the labour spent on behalf of the state on the production and distribution of public goods'. That is, due to tax interference by the State, the productive labour of wage earners will include unpaid labour not only for their employers, but also for the State. The working class in the marxist model is, therefore, exploited not only by their private employers, but also by these same employers on behalf of the State. Furthermore, the labour value of public goods provided by the State, is less than socially necessary labour time required for their reproduction and production of these goods. This Kratke ascribes to the unpaid labour of State employees who are exploited by public employers and by the administration of public utilities on behalf of the State itself.

According to Eaton (1949:162), this exploitation of the working class by the State extends as far as to the management of the national debt. Briefly, Eaton argues that the interest on public debt (which is really only a form of surplus value), is collected by the State from the proletariat through taxation. It is channelled back to the owners of the debt (capitalists) in the same way as companies pay interest on loans.

For Eaton, therefore, the only difference between the State and a company is that the latter pays interest out of surplus value created by workers in operations in which the borrowed capital is used, whilst the former appropriates surplus value created elsewhere with other capital borrowed by the State.

To sum up: in the marxist model, the tax system performs two major functions (O'Connor, 1974:210). Firstly, it allows monopoly capital to increase its income and wealth and thereby ensure its class dominance. Secondly, by taxing the working class and small business sector, it prevents capital accumulation by the proletariat and petty bourgeoisie, forcing them to remain dependant on capital and the State.

1.4.3 Fiscal Crisis

The last aspect of marxist public finance examined deals with the so-called 'fiscal crisis' of the capitalist State. This particular field of 'fiscal sociology' is the least neglected aspect of marxist public finance, with notable contributions coming from O'Connor (1973) and Gough (1979).

The fiscal crisis literature largely stems from O'Connor's early work, has diverse interpretations and is bitterly contested (see Block, 1981; Musgrave, 1980). What is common to all the approaches, however, is the notion that a fiscal crisis emerges in advanced capitalist economies when government expenditure requirements outpace revenue capacity, manifesting in a number of symptoms including; increased inflation, tax resistance, increased deficit financing and debt. As Block puts it:

".[Fiscal crisis is].....a condition of national societies where the expenditure of all levels of government taken together expands as a percentage of GNP fast enough to produce such symptoms as inflationary pressure, tax resistance, strong pressure for limits on government spending, and a pattern of fiscal pressure on state and local governments."
(Block, F., 1981, p.5).

According to O'Connor, the legitimacy of the capitalist State depends on its ability to provide a range of services to the general population, without having to raise taxes to a level which would be perceived as oppressive. At the same time though, the State remains under great pressure to provide the necessary infrastructure to capital. This social investment, directed mainly at industry and finance, would include outlays on roads, highways, education etc., all of which provide the necessary conditions for ensuring profitable capital accumulation in the corporate sector. In marxist terms, this investment would increase the productivity of labour by adding to the stock of constant capital. Similarly, by providing social consumption expenditure (i.e., expenditure on social insurance, public health and welfare), the State assists the corporate sector (i.e., raises profits) by reducing the wages necessary for the reproduction of labour. Capital, however, remains resistant to high taxes. Consequently, the State is forced to rely largely on taxation of the working class for finance. As O'Connor puts it:

"the problem of financing the budget reduces itself to the problem of increasing taxes, specifically the problem of intensifying tax exploitation of the working class, owners of small businesses and self-employed professionals."
(O'Connor, J., 1974, p.136).

These sectors, however, have a limited capacity for extraction. The inevitable result is, therefore, a fiscal crisis, itself reflective of the capitalist crisis at large. In essence, the State carries its own 'seeds of destruction' since the revenues from these sources are the only means by which the State can ensure the long run reproduction of the capitalist mode of production. When the State is eventually unable to fulfil this

role effectively, a fiscal crisis emerges which ultimately brings about the collapse of the capitalist state.

Gough (1979) has also examined the fiscal crisis issue in some depth, focussing specifically on events in the UK between 1974 and 1978.

Gough's basic argument is that the fiscal crisis of the State, itself a reflection of a more fundamental crisis of accumulation, is brought about the interaction of two major forces. The first is the exhaustion of the reserve army of labour in advanced capitalist countries, and the second stems from a strengthening of the labour movement. Gough argues that in Britain in particular, this same crisis (occurring during the middle 'seventies) was further exacerbated by increased competition from the USA in technology and by a sharp increase in the prices of raw materials.

According to Gough then, these forces, together with working class pressure for improved welfare payments and resistance to increased taxation, manifested themselves in inordinarily large deficits and increased privatization, i.e., symptoms of a fiscal crisis.

Although marxist analysis is not difficult to criticise (especially from a neo-classical perspective), it is not the purpose of this thesis to attack the premises from which the theory is derived. This has been done elsewhere. Rather what should be noted, is the one major limitation of the marxist paradigm which has a direct bearing on our analysis, i.e., the

narrow reliance on the two-class labour-capital scenario.

In his critical review of the marxist fiscal crisis literature, Musgrave highlights this particular limitation well. In his own words:

" There is much to be said for the Marxist tradition of emphasizing the importance of social groups, rather than isolated individuals as forces that determine fiscal change. But it is incorrect and misleading to formulate the issue in terms of a two-class, capital-labour model...Closer consideration of the fiscal process, especially in its modern setting, shows that many groupings must be considered and that most of them cut across the Marxist class division. Moreover, the groupings interact, so that few problems can be understood correctly as bilateral conflicts."
(Musgrave, R., 1980, p.370).

Thus, whilst some important insights can be gained from marxist class analysis, in reality the whole political economy is far more complex than the marxist simple dichotomy suggests. Modern society is in fact characterized by huge overlaps between the interests of capital and labour. For this reason therefore, it is likely that there is far more to be gained from analysing conflicts surrounding the distribution of the tax burden in terms of other less rigid variables (income groups for example), rather than in terms of only capital and labour.

PART TWO: EVIDENCE

CHAPTER TWO: THE EVOLUTION OF THE SA TAX STRUCTURE (1946/47-85/86)

2.1 Introduction

In the previous chapter, three possible interpretative approaches to the evolution of tax structures were discussed. The economic development, public choice and marxist perspectives together provide a useful theoretical framework for analysis.

In this chapter the evidence is presented. The evolution of the South African tax structure over the forty year period is described, highlighting the major policy innovations and structural changes considered relevant to this study. At the same time an effort is made to incorporate the role that various government appointed bodies have played in the determination and formulation of tax policy¹(see Browne, 1974, 1983, 1984; Franzsen, 1984; Falkena, 1980; Van der Heyns, 1982). Throughout, the emphasis is descriptive and the primary aim of this chapter is to provide the historical and statistical material for use in later analysis.

The first section comprises an overview of the tax structure as it appeared at the end of 1946. Thereafter, the remaining forty years are divided up into four separate sections, each roughly corresponding to periods of major policy realignment. Each of these sections includes; a description of significant tax policy innovations and a brief review of trends in the size and composition of revenues.

2.2 The Structure of Taxation - 1946

The system of taxation imposed by the Central government at the end of 1946, was broadly divisible into direct and indirect taxes. The former consisted mainly of income tax and the latter principally of customs and excise duties (see Social and Economic Planning Council (S.E.P.C.), Report No. 7, 1945). Income from these two major sources, which amounted to 81% of total government revenues, were collected by the Departments of Inland Revenue and Customs and Excise respectively. These funds were in turn paid into the Consolidated Revenue Fund (Sec 17/South Africa Act, 1909) under the control of the Treasury.

a) Income tax

The start of income tax in South Africa, as it is known today, was initiated soon after Union (1910), with the passing of the Income Tax Act (No.28) of 1914. Prior to Union, only the Cape (Act No.36 of 1904) and Natal (Act No.33 of 1908) colonies imposed any form of general tax on income (see, De Kock, 1922, 1924, Botha, 1936).

The 1914 Act, like the earlier Cape Act, was based on the British New South Wales Act of 1895, which defined 'income' as 'gains' or 'profits'. This strong colonial influence, which extended to many of the tax instruments used, was also very evident in perceptions of equity, 'fairness', efficiency and law.

The provisions relating to personal income tax, for example, clearly reflected this. Consistent with the early

British tradition, they had an extremely limited application, with all incomes of £1 000 p.a. and less completely tax free. Thereafter, rates payable were based on a finely graduated scale which rose by 1/2000 part of a penny per Pound, and which reached a maximum level of 5% for incomes exceeding £24 000 p.a..

The 1914 Act was amended by the 1915 Act (No.23), which in turn was repealed and replaced by the Income Tax Act (No.41) of 1917. This Act consolidated the laws relating to income tax and mining taxation and introduced a Super tax, Dividend tax and Excess Profits duty. These latter two taxes were, however, short lived, and were soon abolished with the passing of the Income Tax Act (No.40) of 1925 (see Trotter, 1969:331-332).

Fifteen years later, the Income Tax Act (No.31) of 1941, by far the most comprehensive of all the Acts passed until this time, finally consolidated the Union's income tax laws.

This Act, with amendments, was still in force at the end of the war.

The 1941 Act was basically characterized by two major taxes; 'Normal' and 'Super' tax, both of which were levied on the 'taxable incomes' of individuals and companies. The notion of taxable income, introduced by the earlier 1914 Act, was crucial to the operation of the tax system and remains to date a cornerstone of South African taxing philosophy. Also, since both these taxes were progressive, they were inextricably bound up with the concept of 'ability to pay' rather than the 'benefit' principle of tax equity, as is the case today.

1) Individuals

Normal tax payable by individuals under the 1941 Act, was calculable by means of a formula shown below:

$$\text{Tax Payable} = (18^* + \frac{\text{taxable income}}{1000})^d \text{ per Pound}$$

* 15 for married individuals

According to this formula, rates of tax were based on a graduated scale which increased by one thousandth of a penny per pound. At income levels of £21 000 (R42 000) p.a., maximum rates of 36d (15%) and 39d (16,25%) per pound, were payable by married and unmarried persons respectively.

The starting level at which Normal tax had become payable had also fallen over the years, and, after allowing for deductions, individuals earning in excess of £300 (R600) p.a. were liable for Normal tax. Families on the other hand were exempted up to a higher level, due to the operation of larger family rebates. Thus, from an early stage, it was an established principle in South African tax philosophy that 'ability to pay' fell with growth in the size of the family.

Certain individuals were also liable for Super tax, another feature of the 1914 Act. This tax, essentially a progressive tax on high income earners, was determined by adding to the taxable income derived for Normal tax, the value of all dividends received. This 'adjusted' taxable income, in turn, provided the basis for the calculation of Super tax using a formula similar to

that used for the calculation of Normal tax.

This differentiation between dividend and non-dividend income earners ensured a high degree of progression in the tax system, since Super tax liability only began at £1 750 (R3550) p.a.. Thereafter, Super tax rates were steeply progressive and rose by $1/400^{\text{th}}$ of a penny per pound. At £26 400 p.a., a maximum rate of 90d (37,5%) per pound was payable on qualifying income.

A form of personal income tax was also payable by Blacks. However, unlike White taxpayers, they were subject to separate provisions, mostly brought about by the altogether different demands placed on the function of Black taxation.

Very briefly (see Chapter 5), by 1946, Black taxation was already part of a long history of fiscal discrimination, beginning formally with the passing of the Glen Grey Taxation Act in 1894 (see Ncgobo, 1964). The purpose of this Act, characterised by a labour tax, was primarily to ensure a constant and certain supply of cheap Black rural labour for the diamond and gold mines (see Van der Horst, 1942:110-116; Fletcher, 1972).

However, by 1925, revenue considerations had also emerged and the Native Taxation and Development Act (No. 41) of that year was passed to deal with this. This Act repealed all previous Acts in the four provinces and introduced a uniform tax policy for the whole Union (see De Kiewiet, 1941:235).

By 1946, three main forms of direct tax were payable by Blacks.

- a) A general tax of £1 per annum payable by all

Black males between the ages of 16 and 65;

- b) A local tax of 10 shillings a year per hut, to a maximum of £2
- c) Quitrents payable in parts of the Cape Province.

ii) Companies

The income tax provisions of the 1941 Act clearly distinguished between public and private companies. On the one hand, private companies did not pay tax per se, since all their taxable income was automatically apportioned to shareholders according to their right to participate in the profits of the company. On these dividends received, individuals paid Normal and Super tax accordingly. Public companies on the other hand were taxed at the source and paid Normal tax at a flat rate of 20%, with all dividends distributed by them, subject to Super tax in the hands of the final recipients.

This differentiation between private and public companies did, however, give public company shareholders considerable tax advantages. Consequently, in an effort to correct this inequality, the 1941 Act also introduced an Undistributed Profits Tax (UPT) for public companies, payable at a rate of 20% on a calculated level of undistributed profits. Clearly, the UPT was not so much a tax, but rather a means through which government tried to 'encourage' public companies to distribute a 'fair' share of profits on which Super tax could be levied.

In addition to the UPT, another subsidiary direct tax imposed was the Non-Residents' Shareholders Tax (NRST). At a rate of 7,5%, it was simply a form of Super tax on foreigners who could not be

taxed under the existing taxing arrangements. It was collected at the source by the company and remains in force today at a rate of 15%.

Mining companies were also liable for income tax under the 1941 Act. However, unlike ordinary companies, they were subject to separate and generally higher tax rates. This was especially true of gold mining concerns².

This policy of differentiated tax rates for the mining sector, although partially evident in early taxes in 1898, first emerged clearly in the Mining Tax Act (No. 6) of 1910. It later became fully entrenched in tax policy in 1936 (Act No. 34 of 1936) after the departure from the gold standard some four years earlier (see West and Williams, 1984:13-36).

Numerous amendments followed, and by 1941, gold mining companies were subject to a flat rate tax of 15% on profits, as well as to a Formula tax (to a maximum of 35%) of the type given below:

$$Y = 40 - \frac{500}{X}$$

Where:- Y = Rate of tax expressed as a percentage.
X = The ratio (expressed as a percentage) by which the taxable income derived from gold mining bears to the income earned therefrom.

Expressed in this form, the method of taxing the gold mines meant that tax rates were essentially dependant upon the ratio that taxable income bore to income derived from mining operations. This also meant, therefore, that 'effective' tax rates could vary considerably according to the grade of ore mined.

A further direct tax liability levied on gold mines took the form of a mining Lease payment under the Mining Tax Act (No.6) of 1910. Calculated using a Formula similar to the one presented above, this 'tax' or charge was essentially a rent payable by the mines to the State for the right to mine, and is still in force in a form today³.

b) Customs and Excise

The second main source of revenue for Central government was indirect taxes, mainly customs and excise duties⁴.

Customs duties first became payable in the Union under the Customs Management Act (No.9) of 1913, which was passed to incorporate the separate provisions of the four colonies. Prior to this Act, there had been free trade throughout the country.

This Act was repealed some 30 years later and replaced by the Customs Act (No.35) of 1944. This Act imposed duties on a wide range of imported goods, using what was generally referred to as the 'three line tariff system'.

This tariff system served at least three functions. Firstly, there were duties (minimum, intermediate and maximum) which were levied primarily for the purpose of yielding revenue. Secondly, there were other duties levied with the main objective being the protection of certain newly established (infant) industries from foreign competition (although at the same time raising revenue). Thirdly, the schedule of tax rates, once again reflecting the colonial influence, was designed to encourage imports in favour

of Great Britain and other members of the Commonwealth (see Botha, 1973).

Besides these customs duties, the government also levied excise duties on a number of domestically produced commodities. These duties were imposed under the 1942 Excise Act, which also had its origins in the 1913 Customs Management Act. Prior to the 1913 Act, all the colonies had enforced their own separate excise duty provisions (as was the case with customs).

By the end of 1946, excise duties had become payable on a number of domestically produced articles including; liquor, tobacco, yeast, playing cards, sugar, fuel and tyres. However, since many of these commodities had only become liable for taxation during the course of the war (i.e., as a form of rationing), by 1947, a number of previously taxed commodities had once again become exempt.

Lastly, the Central government also received a limited amount of revenue from a number of other minor taxes and charges. These sources included; Transfer duty, Death duties, Licenses, Stamp duties, Fees, Interest and Dividends.

At the end of the 1946/47 fiscal year, Central government's total tax collections topped £107 (R214) million. Measured as a percentage of GDP, this put the post-war tax ratio, or tax 'burden', at around 13.1%, a figure well up from the pre-war average of around 9% (see Table A and Table 2.1).

The composition of the 1946 revenue was as follows: 23% derived

from customs duty, 21% from individual income tax, 16.8% from excise duty, 11.2% from mining revenue and 7% from companies. All the other taxes and charges including; Stamp duties and Fees (4%), NRST (1,4%), Transfer duty (2,8%) and Interest and Dividends (3,2%), together comprised the remaining 20% (see Table A, Table 2.2, Table 2.3 and Table 2.4).

2.3 1946/47 - 1954/55

The period 1946/47 to 1954/55, can be regarded as possibly the most significant period in South African tax policy history. The policy innovations introduced at budget times, together with the views expressed by government on a number of official tax reports, firmly established much of the immediate post-war tax philosophy, major features of which are still inherent in tax policy today.

The first official enquiry into the tax system was contained in Report No. 7 of the Social and Economic Planning Council (U.G. 48/ 1945). One of a series of Reports, it had been released by the Council with the primary aim of helping government formulate an integrated post-war economic policy. It was also the first ever full scale enquiry into the country's tax system as a whole.

According to the Council, the tax system had additional functions besides the traditional one of raising revenue to finance government expenditure. Specifically, they argued that the tax system had a role to play as an instrument of socio-economic policy.

In this regard, the Council identified a number of 'extra'

functions namely;

- a) The long term maximization of National Income;
- b) Cyclical stability and the maintenance of a high level of employment;
- c) The alleviation of extreme inequalities of wealth;
- d) The prevention of socially harmful practices.

It was these four 'social' norms, together with a number of other more conventional criteria, which provided the framework for the Council's examination of the whole tax system.

Although the Report finally declared the tax structure 'basically sound', it nevertheless highlighted a number of areas which the Council felt required urgent attention in the interests of 'efficiency' and 'equality'.

The first major recommendation, and one which clearly underlay the basic philosophy of the Report, stressed the need to place a greater reliance on direct progressive taxation, and in turn, less on indirect taxation. In the Council's words:

"The tax system as a whole, should be progressive and should not press unduly hard on the lower income groups. Greater reliance should be placed upon direct taxes especially death duties and income tax and in the long run, smaller reliance on indirect taxes, particularly customs and excise duties, and concealed taxes on the necessaries of life."
(S.E.P.C., 1945, p.54).

To a large extent, this proposal was based on the Council's understanding of tax incidence, in which they saw the burden of indirect and 'concealed' taxes borne primarily by the poorer sections of the community. These taxes were, therefore, highly

regressive, and thus believed to be partly responsible for the continued prevalence of wealth and income inequalities in SA.

Their second major recommendation related to fiscal policy and was clearly influenced by the then newly postulated ideas of Keynesian contra-cyclical budgeting. Once again reflecting the belief that the government had the capability and responsibility to maintain a high level of employment and growth, the Council proposed that, 'on expert advice', a system of anti-cyclical budgeting should be adopted, whereby 'deficits are incurred during depressions and surpluses during prosperity' (S.E.P.C., 1945:53).

In addition to these two recommendations, which capture the underlying philosophy and spirit of the Report, various other recommendations were made in a similar vein. These dealt with amongst others; proposed changes to farmers' taxation, private company taxation, war-time taxation and Black taxation. They also offered an alternative approach to gold mining taxation.

Taking a broad view of the Report, therefore, it was evident that the Council's proposals, as a whole, recommended a fairly drastic change to the existing status quo. In parts, the Report even went so far as to propose changes to a number of tax policies which themselves formed part of a much broader ideology (e.g., Black taxation). Not suprisingly then, most of their recommendations were rejected by the government at the time.

In later years, however, the Report did achieve some degree of influence when the government introduced a number of piece-meal

changes (e.g., PAYE) to the system which had been first proposed in this Report, and later recommended and endorsed by others.

A second major report also released in 1945 was more narrowly focused, dealing specifically with the contentious issue of gold mining taxation.

Before considering this report though, a brief review of the history of gold mining taxation since at least 1932 is a useful prerequisite, since this puts the whole issue of gold mining taxation in an appropriate historical perspective.

Prior to 1932, the taxation of gold mining companies had not been a particularly disputatious issue. Tax rates for the mines were pitched at levels above the corporate norm, but were generally regarded as 'acceptable'. In 1932/33, however, taxation became an issue with the taxing authorities after the rise in the gold price from £4.3 to £6.2 and South Africa's departure from the gold standard earlier in that year.

This large 'devaluation', which had the immediate effect of raising the value of current output of the mines by some 20 million pounds, created an enormous windfall profit for the gold mining industry as a whole. However, under the existing taxing arrangements, this did not necessarily imply higher tax returns for the State coffers.

In the 1933 budget speech, the Minister of Finance set about correcting this situation. Putting forward the government's position, the Minister stated that the good fortune of the mines,

was due 'solely to state action' and that consequently, the government 'need not be concerned with any claim that the money belongs to the shareholders' (Hansard, 1933, Vol.20, c.61).

On the basis of this rationale, the government in the same year introduced a new gold tax, the Excess Profits duty. Calculable on the difference between 'standard' and 'normal' profits, this tax became payable in addition to the flat rate tax and the Formula tax already in force. The effect of this incorporation was to significantly raise the total tax contribution from the mining sector over the whole period in which it was applied (see Kaplan, 1977:250-260).

In 1935, with further rises in the price of gold, a Gold Profits Surtax was added to ensure and maintain the State's share of the changing fortunes of the gold mining industry.

This somewhat ad-hoc approach to taxing the mining sector did not last long, meeting with opposition from a number of sources (see Chamber of Mines (C.O.M.), 1946). Consequently, in 1936, the income tax, Excess Profits duty and the Surtax were all scrapped and replaced by a flat rate tax of 15% and a Formula tax similar to the one described earlier.

With the exception of the Special War-time contribution introduced in 1940, this basic structure remained unchanged until the appointment of the Holloway Committee of Enquiry in 1945 (U.G. 16/ 1946). This government established committee was asked to investigate the whole system of gold mining taxation and to submit recommendations for its improvement.

Essentially the Committee's report was based on the concept of the so-called 'pay-limit' i.e., the principle determinant in the decision as to whether to crush a particular grade of gold ore or not. In this regard the Committee maintained that the method of taxing the mines should be so designed to reduce the effect that taxation costs had on the calculation of this limit. Simply put, the Committee recognised that certain taxes tended to raise the pay-limit and in so doing lower the volume of gold ore crushed. In the long run, they realised that this would result in more gold left unextracted and, therefore, less revenue for the State.

In an effort to correct this situation, the Committee recommended inter alia;

- a) The abolition of the Normal tax as applied to mines.
- b) That the taxation of gold mining profits remain on the basis of a Formula tax itself based on a sliding scale of the ratio of profits to recovery.

$$Y = A - B / X \quad \text{where;}$$

Y = The rate of tax expressed as a % of income.

X = The ratio of profits to recovery.

A, B = Coefficients which determine the yield.

- c) That the Special Contributions Tax be abolished and instead become incorporated into the new Formula tax.
- d) That the existing system of capital write-offs be replaced by a new system in which all new mines capital expenditure would be treated as a cost for tax purposes. (For existing mines the amortization exemption would constitute 20% of the unredeemed balance in any one year).

The Committee's recommendations had three basic aims:- Firstly, the formula tax was designed to encourage the mining and crushing of low grade ore, maximising the amount of gold extracted and minimising the quantity of gold (wealth) left unrecovered.

Secondly, the system of capital deductions proposed was designed to encourage future gold mining output and in so doing guarantee higher gold and taxation yields for the future than would otherwise have not been the case. Thirdly, and most importantly, the decision to continue using a Formula tax with variable coefficients, was again aimed at ensuring a relatively high rate of taxation for the gold mining sector as a whole.

On the controversial question of higher tax rates on the mines, the Committee took an opposite view to that of the 1945 Council Report i.e., that 'discrimination' in rates was not inequitable but justified in the light of the 'unique' relationship that existed between gold, general economic prosperity and the claims that citizens had on the wealth of the country. In their own words:

"..we hold that it would be wrong in principle for the State to limit its taxation of the surplus product of a wasting asset to the same level as it extracts from industries with a more or less indefinite life."
(Holloway Commission, 1946, p.15).

So persuasive was the argument that in 1946, the government accepted these proposals as the 'basis.....(of).....gold mining taxation'. To date, this system with only minor variations in form, remains the basis for gold mining taxation (Browne, 1983:138)⁵.

Another official enquiry into the tax system appeared soon afterwards in 1951. This report comprised the findings of the Commission of Enquiry into the Income Tax Act, under the chairmanship of Raymond Steyn (U.G. 75/1951; U.G.63/1952).

The Steyn Commission of Enquiry, appointed in 1949, had been given fairly wide terms of reference to investigate the workings of the Union's income Tax laws (excluding mining), and to express recommendations for its improvement (see Lavine, 1952; Woods, 1953). The recommendations which followed, most of which were of a technical nature, were in turn examined by the Diederichs Committee (U.G. 11/ 1954) appointed specifically for this purpose.

Among the major non-technical policy recommendations, some of which were endorsed by the Diederichs Committee and later accepted by the government, were:

- The maximum marginal rate of tax payable by individuals not exceed 62,5% beginning at incomes in excess of £12000(R24 000). (Accepted in 1952/53).
- The marginal system be dropped in favour of a block rate system (subsequently endorsed and implemented in 1960).
- Farmers no longer be entitled to be assessed on the 'cash basis' but instead become liable under the 'stock basis'. (Accepted and implemented in 1954).
- Capital gains remain excluded from the tax system.
- A system of 'concessional deductions' (abatements), replace the existing rebate system in force. (Also recommended by Franzsen and introduced in 1971).
- The Union government discontinue the levying of Normal tax on the incomes of individuals and vest in each province the right to impose Normal taxation according to predetermined rates, and that in return, the provinces cease to impose personal, provincial and company taxation. (This recommendation was rejected).
- The apportionment system used for the taxation of private companies be scrapped and replaced by the system applicable to public companies. (Accepted in 1952).

Their last recommendation requires further elaboration, as it succeeded in providing a partial solution to one of the more contentious issues of post-war tax policy.

Prior to 1941, the taxation of private companies had been relatively simple. These companies paid Normal tax on their taxable income (which was at a rate slightly higher than individuals) and did not pay any Super tax. On the other hand, in order to complement the system, individuals were exempt from paying Normal tax on dividends received, since the company had paid this, yet paid Super tax on taxable income including such dividends.

From an equity point of view, this method of taxing had some inherent advantages since it reduced the extent of certain aspects of double taxation. However, at the same time it also provided a means by which wealthy taxpayers could avoid Super tax obligations. By simply floating a company having only the family as shareholders, this company, a separate legal entity, could receive all investment dividends. Under the existing legislation, these dividends remained free from Super tax as long as they were not declared and distributed. Widespread avoidance through this practice had, therefore, resulted in a considerable loss of income to the State finances.

Consequently, in the 1941 Act a distinction was made between private and public companies in an effort to curb avoidance and enforce compliance. This Act defined public companies fairly rigorously, and all concerns which did not fit the definition were deemed private. The general idea was to maintain the status quo for public companies, whilst at the same time eliminate private company tax avoidance. Furthermore, as stated earlier, UPT and NRST were also introduced at the same time to complement the whole system.

Under the new system public companies paid tax in much the same way as before. Private companies on the other hand were not liable for Normal tax and their whole taxable income was apportioned to shareholders of the company according to their right to participate in the profits of the company. These shareholders were then liable in their own right for both Normal and Super tax on the 'dividends' received. It thus became immaterial whether or not a private company paid dividends.

The new system of company taxation again proved unsuccessful. Following the recommendation of the Steyn Committee (subsequently endorsed by the Diederichs Commission), a decision to scrap the apportionment system was taken early in 1951. The effect of this change was essentially to put private companies on the same footing as public companies regarding the treatment of profits, dividends and tax rates. This remains the situation today.

The principal reason given for the change by both government and the Committee centered on the detrimental effect that the apportionment system played in the determination of company formation and consequently capital formation. In the Committee's own words:

" It would in our opinion create an unnatural and unhealthy state of affairs if taxation considerations became a dominant feature in the determination of the question whether or not companies should be formed for purposes of conducting business."
(Steyn, 1952, p.54).

Two years later, substantial tax cuts in both Super and Normal tax rates followed. In the case of Normal tax, the tax rate was

adjusted to remain progressive only up until £9 300 (R18 600), instead of £16 000 (R32 000). Thereafter, the maximum flat rate imposed became 14% for married persons and 15% for unmarried persons instead of 19,5% and 21% respectively. In the case of Super tax, the maximum rate payable was also reduced from 43,33% to 29%, starting at £9 300 (R18 600) instead of £16000.

The net effect of these tax reductions, a product of a Steyn Committee recommendation, was to reduce the overall tax bill for individuals with incomes in excess of £9 300 (R18 600). At the same time though, all individuals with incomes below that continued paying tax as before.

The primary reason given for this marginal rate concession was the need to stimulate savings by the high income groups. Indeed, Central government rates, coupled with provincial tax rates, had prior to this resulted in the combined maximum marginal rate in some provinces exceeding 90%, substantially reducing the ability and willingness to save.

Together with the company and individual income tax concessions came the re-introduction, in 1954, of the manufacturer's initial allowance which had been part of the tax system between 1945 and 1947. This new initial allowance, at a rate of 10%, was much broader than before, and was brought in to 'increase efficiency in the private sector' through accelerating the depreciation allowance on new plant and machinery. These allowances were again extended and broadened in 1959, 1969 and 1974, and were coupled with an investment allowance in 1960, itself extended in 1966, 1970, 1973, 1974, and 1975 (see De Loor Commission,

W.P.H./ 1983).

Other changes occurring over this period include: the scaling down of individual tax rates (1948), the introduction of a Marketable Securities Tax (1949), changes to farmers taxation (1954) and a number of minor changes to the gold tax formula (various years).

Over the nine year period (1946/47-1954/55) total tax collections more than doubled to R456 million (1954/55) from R214m (1946/47) (Table 2.1). This represented a real growth rate of approximately 4,9% per annum, similar to the growth in GDP and thus maintaining the overall tax ratio at a relatively steady 11-13%.

The composition of revenue collections on the other hand, underwent greater variation (Table 2.2 and 2.3). The most significant changes were in the contributions of company tax, which rose from 7% to 23% and customs and excise which fell from 39% to 26%. The other major revenue shares remained fairly constant with individual tax at 23%, mining at 10%, and 'all other' at 17%.

2.4 1955/56 - 1967/68

The period 1955/56 to 1967/68, was generally speaking, a period of consolidation and rationalisation in the tax system. Far fewer policy changes were introduced over this thirteen year period, than had been the case in the previous decade.

The first major policy innovation of the period took place in

1955, with the reintroduction of the UPT - a feature of the tax system between 1941 and 1951.

Again, the stated purpose of the tax, now at 25%, was to encourage companies to declare a higher level of dividends to shareholders, on which individual income tax could then be levied. Since private companies were again singled out as being responsible for large scale avoidance, it was surprising UPT was reintroduced for both private and public companies.

In the budget speech of that year, the government reiterated that the UPT was not so much a tax as it was a means to combat large-scale tax avoidance. In Finance Minister Louw's words:

"The object of the tax, is to encourage companies to distribute reasonable dividends, so that share-holders will be obliged to contribute their fair share to the exchequer in the form of super tax."
(Hansard, 1955, Vol.88, c.3233).

Two years later (1957), the first major move towards the centralization of revenues was made. A second move completed this in 1971.

Prior to 1957, the four provinces each levied personal, individual and company taxes according to their own pre-determined rates. Revenues from these taxes were collected by Central government on the provinces behalf. However, since the Central government also levied similar taxes, an unsatisfactory situation had emerged in which tax rates varied across provinces.

In 1957, the first steps were taken to correct this when the

Central government took over the collection of company tax from the provinces. At the same time it withdrew the right of the latter authorities to continue levying such taxes. In practice, this move was accomplished by raising the Union company tax rate by 1 shilling in the pound (5%) to 30% per Pound. It was further agreed that part of this increase would be redistributed back to the provinces on a percentage basis through increased subsidies.

A year later, the first significant change to the taxation of Blacks was made, when the basic poll tax payable by Black males was raised from £1 (R2) to £1.75 (R3,50) per year. In addition, a graduated general tax for incomes in excess of £180 (R360) per annum was introduced. The government claimed at the time that rising education and welfare costs had made this step inevitable (SAIRR, 1958:5).

This change followed on from an earlier move in 1955, when the Bantu Education Account was introduced, from which it was intended that Black education costs could be met.

The financing of this latter account was to be made up of 4/5 of the general income tax on Blacks, plus a fixed statutory grant of £ 6.5m (R13m) from government. To a large extent, this was a return to the pre-1945 system, and reflected government policy that the Black man 'make a bigger contribution' to financing his 'own' education costs.

In 1960, a major change was made to the method of calculating individual tax liabilities, although this did not make a substantial difference to the amount of tax actually paid. It

was also the first move in a series of three aimed at greater rationalisation.

Following a recommendation made by the Steyn Committee (also endorsed by the Dept. of Inland Revenue), the Normal and Super taxes, which had until then been levied separately by the government, were consolidated into a single tax termed 'Normal tax'. In addition, the Formula system which had been in operation until then, was scrapped and replaced by a new block rate system.

Under this new scheme, tax liability no longer rose successively with every additional pound earned. Rather, the system was designed so that for a given level of income a certain amount of tax was payable, with all income in excess of that amount (i.e., before the next block) being subject to a stipulated marginal amount. Both the rates per block and the marginal rate payable rose as taxable income increased. At R18 000, a maximum marginal rate of 50% was imposed.

Although other factors certainly played a role (see Lavine, 1960), the explanation put forward by governments at the time stressed that the purpose of the change was simply to reduce excess calculation complications for the Department of Inland Revenue. In the Minister of Finance's words:

" This involved system, makes it difficult for the individual taxpayer to calculate his tax liability and the complicated calculations which it involves also imposes a very heavy burden on the staff of the Inland Revenue Department."
(Hansard, 1960, Vol. 103, c.2510).

With the block rate system firmly in force, the next major

innovation to the tax came in 1963, with the introduction of the Pay-As-You-Earn system of tax deduction at the source.

The idea to introduce the PAYE scheme, already commonplace overseas, had been mooted as early as 1945 (e.g., S.E.P.C., 1945). It had later been formally endorsed by a Parliamentary Select Committee in 1962 (S.C. 3/ 1962). It had also been given the backing of the Department of Inland Revenue and the Reserve Bank, which stood to gain from increased real tax revenues and a more stable money supply respectively.

The basic aim of the PAYE system was to introduce a method of taxation in which tax payments could be closely linked to income earned on a regular basis. Simply, instead of employees paying tax once yearly in arrear (by which time tax payments had also depreciated in real terms), payments could be made monthly at the place of work.

In operation, the employer would deduct from all employees monthly income, a monthly tax contribution, calculated according to a prescribed set of tax tables. This system would thus ensure tax payments were made almost concurrently with income earned. Employees could then still submit a yearly tax assessment in order to present the full picture and to claim deductions that could not be ordinarily completed at the place of employment.

Since the PAYE system was aimed specifically at salary and wage income earners (employees), all persons which were not incorporated into the system, and who earned a given amount of income, automatically became 'provisional' taxpayers (e.g., employers,

self employed professionals, companies etc.). Provisional taxpayers, instead of paying their tax once yearly in arrear would have to pay provisional tax bi-annually in advance. In order to make the change-over easier, and also to give businesses time to organise, a tax 'holiday' was granted over the transition period.

The remainder of this period (1964 to 1968), was relatively uneventful, and was characterised mainly by changes to the existing rate structure. Four trends in rates are worth reviewing:

- Firstly, in 1964, the tax rates in the so-called 'bulge' were scaled down considerably. The average tax rate payable between the incomes of R4 600 and R5 000, were reduced from 21,3% to 13,3% and in the range R5 000 to R6 000 from 33,3% to 26,6%. The resulting loss of income was passed in the form of higher taxes on incomes in excess of R12 000.
- Secondly, over the period 1965 to 1967, the company tax rate was raised in three separate occasions. In 1965, the rate was raised from 30c to 33c per rand, in 1966, a further 3,33c to 36,33c, and in 1967, to 40c (inclusive of the loan levy). This last rise meant that the effective company tax rate (i.e., the rate including the loan levy) doubled from 20% to 40% in only sixteen years.
- Thirdly, NRST was raised in two separate occasions from 7.5% to 10% in 1966 and again to 15% in 1967. This last year also saw the introduction of the Non-Residents Shareholders tax on interest at a rate of 10% collected at the source.
- Lastly, the same period 1960 to 1963, also witnessed the gearing of the tax system toward the protection of the Balance of Payments. In each of these years, measures either to encourage exporters (export concessions) or to dissuade imports (import charges) were passed in an effort to produce a surplus on the trade account.

Other changes which took place over this period included; adjustments to the spouses rating formula (1954), a new Estate duty Act (1955), the introduction of Donations Tax (1955), the inclusion of Building Societies into the tax net (1959), the passing of a new Consolidated Income Tax Act (1962), the extension of depreciation allowances (1960) and special tax dispensation

measures to post-1966 gold mines.

This same period also witnessed a rise in the tax ratio from roughly 12,6% of GDP in 1954/55, to 14.6% in 1967/68. This reflected an average real growth rate of approximately 4,9% p.a.

The source of this growth lay in the returns from mining revenue, company and individual income tax, which contributed 55%, 27,5% and 19,1% respectively to the growth in total revenues. These reflected real growth rates of 10%, 6,5% and 4% in each of these major tax sources.

The composition of taxes on the other hand varied only slightly, with the company tax share rising marginally from 22% to 25%, and mining revenue's share from 10% to 12%. The shares of customs, excise and individual tax remained basically unchanged from the previous decade.

2.5 1968/69 - 1975/76

The period 1968/69 to 1975/76, was characterized by a number of major structural changes, most of which followed recommendations of the Franzsen Commission of Enquiry into Fiscal and Monetary policy (R.P. 24/ 1969; R.P. 86/ 1970; R.P. 89/1970). Only the second full scale enquiry into the local tax system as a whole, this investigation paved the way for the introduction of a number of reforms relating to individual, company and indirect taxation.

The Franzsen Commission was appointed in 1967, and was given fairly wide terms of reference to enquire into, among other

things; the system of taxation in the Republic, and to submit recommendations 'which would tend to promote economic growth..(and)...financial stability.'⁶

A year later, the Commission published its First Report, in which it argued that, were the then existing system to remain in force without change, future economic development would be 'severely impeded'.

To a large extent, this central conclusion was based on the Commission's belief that the tax system had become too heavily dependant on direct taxation, in particular, individual income tax. Estimates given by the Commission went so far as to claim that only some 6% of the total tax paying population were responsible for two thirds of the total income tax bill, out of line with international averages (Franzsen, First Report, 1969:4)

In the opinion of the Commission, therefore, realistic reform could only be achieved through individual income tax reductions, a broadening of the indirect tax base and the extention of the 'income' concept to include capital gains. In short, a shift from direct to indirect taxation. In the Commission's own words:

"The emphasis of the present tax system is shifting rapidly from indirect to direct taxes and from direct taxes on companies to direct taxation on individuals. If this development were to continue, a growing number of problems would arise.....the possibilities of reform are to be sought in three directions.....a reduction in the rate of progression of direct tax.....a shift in the direction of indirect taxation through the broadening of the tax base of this form of taxation and.....a broadening of the fiscal concept of income to include capital gains."

(Franzsen First Report, 1969, p.6).

The Commission's approach can of course be contrasted with the earlier 1945 Council Report, which had proposed a shift in reliance in the opposite direction i.e., from indirect tax to direct tax. A second contrast is evident in the approach taken to capital gains. Whilst the 1945 Report had remained undecided, both the Steyn and Diederichs investigations had firmly opposed capital gains taxation. Undoubtedly, perceptions of equity and 'fairness' had undergone considerable change in the twenty five year period which had elapsed.

The first problem with which the Commission had to deal, involved the determination of the maximum marginal rate. In this regard, a number of important variables had to be considered. These included; the effect of high tax rates on work effort, the disparity between individual and company tax rates and its implications for avoidance and evasion, and the negative effects of high tax rates on the ability and willingness of the high income groups to save. On the latter point the Commission remarked:

" the.....current rate of 66% is too high if the state wishes to encourage maximum effort and savings in the higher income groups."
(Franzsen First Report, 1969, p.15).

later it added:

".....the promotion of the higher income groups ability to save must be borne in mind.....(and)....a high rate of progression will increasingly hamper personal saving and, consequently, economic growth as well."
(Franzsen First Report, 1969, p.17).

The Commission was also concerned with formulating an equitable degree of progression in the tax curve, and with the elimination

of the so-called 'tax bulge', which had emerged at income levels between R5 000 and R14 000.

Although savings and work incentive factors again played a role, the Commission's emphasis in the determination of these rates, was strongly geared toward securing the welfare of the poorer sections of the community. This was especially the case in formulating the degree of progression in the early part of the tax curve. As the Commission put it:

"The distribution of income in the country..is very uneven...and...the advantages of government expenditure on social services have not yet been sufficiently extended to the lower group of taxpayers, the degree of progression might be kept fairly low up to a certain income level and be accelerated after that.....(also).....lower income groups already pay substantial taxes in the form of indirect taxes which are with few exceptions regressive by nature."
(Franzsen, First Report, 1969, p.16).

At the same time, the Commission had also set for itself the task of solving the problem that existed between the Central government and provincial administrations. Since both of these authorities levied similar, yet not identical forms of taxation, a situation of differential individual tax rates had emerged in different provinces, as had been the case with company tax rates prior to 1957.

The Commission solution to both of these issues was to recommend that Central government wholly take over the task of levying and collecting the provincial, personal and income tax. It also recommended that the maximum marginal rate be set at 60% (to start at R28 000), and that the degree of progression be kept fairly moderate in the low income range. In practice, this

meant a consolidation of the two sets of tax schedules. The advantages cited were that a centralised system would enable the pursuit of an integrated tax policy, as well as provide the framework for the more efficient operation of PAYE. Revenue would not be lost to the provincial administrations, as they would receive it in the form of increased subsidies, as had been the case with company tax since 1957.

The Commission went on to propose a number of other recommendations regarding individual income tax, the most important of which were;

- a system of rebates to replace the existing system of abatements.
- the elimination of the so-called 'bulge' in the tax curve which occurred at around the R5000 to R14000 level.
- the retention of the progressive bracket system of tax and of the differential system of rates for married and unmarried persons.

The difference between the views of the Franzsen Commission, and that of earlier commissions was again clearly evident. The proposed maximum marginal rate of 60%, for example, was lower than that recommended by both the 1945 Council Report (70%) and the 1951 Steyn Committee (62.5%). A second difference was evident in the approach taken to provincial taxation. In one attempt to solve this problem, the Steyn Committee had recommended that the Central government vest in each province, the right to impose its own form of Normal taxation. In return, the provinces would then cease to levy personal, provincial income and company tax. This was also partly the view expressed by the Schumann Committee (R.P. 35/ 1964). The Franzsen Commission on the other hand, like the Diederichs Commission, saw

greater advantages in increased administrative centralization.

The Commission's second major recommendation, and one which underlay the basic philosophy of the Report, was a call for the introduction of a selective sales duty. Together with a proposed hike in the company tax rate from 36,66% to 40%, the Commission estimated that these two sources would provide the R140 million worth of tax relief that had been conceded in individual tax reductions.

The decision to opt for a selective sales duty (levied at the importer and manufacturer stage), was rationalized on the grounds that it was the only feasible indirect tax option available to South Africa at the time. The extension of existing indirect tax sources, as well as other forms of indirect tax had been considered, but the Commission favoured sales duty on the grounds of efficiency and administrative capability.

The fact that sales duty was a highly regressive tax on low-income earners was noted. However, the Commission argued that its negative effects would not be severe as the sales duty had not been recommended for a wide range of commodities such as food, clothing and certain forms of health expenditure. The Commission further justified its move by claiming that the overall burden of tax for the lower income groups could in any event be expected to fall, with the implementation of the proposed individual tax concessions.

When sales duty was finally introduced in 1969, the Minister of Finance reiterated this same point:

" A broad tax of this kind cannot be painless, but the incidence on the lower income groups should not be heavy and is in any case compensated for by the relief in respect of direct taxation."
(Hansard, 1969, Vol. 25, c.3249).

These recommendations, proposed in the First Report, formed the basis of the reform measures introduced in the 1969/70 budget speech. The following three major changes were announced:-

- The lowering of the individual maximum marginal rates from 68,75% to 62,1% (inclusive of provincial tax) payable at the level of R24 000 for unmarried persons and R28 000 for married (previously of R18 000).
- The raising of the effective company tax rate from 36,66% to 40%.
- The introduction of a selective sales duty as recommended, at a maximum rate of 20%.

On the other hand, the proposed capital gains tax was firmly rejected and did not form part of the government's total policy package.

In 1971, the reform procedure continued when the right of the provinces to levy income tax on individuals was withdrawn and their rates of taxes were incorporated into the Central governments rate. With the combination of these rates (Cape 33%, Natal 37,5%, OFS 32% and the Transvaal 32%), the Central government average rate rose by approximately one third.

This innovation, together with the 1957 change to company tax, resulted in the almost complete centralization of revenue collections to the Central government. This left the provincial and local authorities dependant upon Central government subsidies

and the few taxes left at their disposal, such as racing tax, motor car taxes, licensing and property tax.

Later that year, a new method of calculating provincial subsidies was introduced to take account of the new Central government/provincial authorities taxing arrangements. In the White paper on the Schumann Report (W.P.D./ 1971), the government accepted a new provincial subsidy formula based on:

- a) The needs of the different provinces according to the services they rendered.
- b) The ability of the provinces to finance these requirements according to their income.
- c) The difference between the two which would approximate the subsidy.

A year later in 1972, the surcharge payable by individuals was increased to 15% and the loan levy to 20%. This raised the effective individual maximum marginal tax rate from 72% to a record 78% (inclusive of the loan levy). In other words, the Franzsen reform initiatives introduced just two years previously, had been almost totally abandoned. While this maximum rate did come down again in later years, the whole train of events clearly illustrates the fact that government policy is in no way bound to the recommendations of its appointed committees. In short: commissions advise, but government decides!

Other changes which occurred in this period included; the numerous extensions of the sales duty, the raising of the company tax rate to 42%, the creation of a separate account for the Department of Posts and Telecommunications (1968), the creation of a SWA account (1969) and the discontinuation of the separate Bantu education account (1972). (The passing of the 1969 Black

Taxation Act is discussed in the next section).

The tax ratio which had risen from levels of around 14% and 17% in the late 'sixties and early 'seventies, maintained its upward climb over this eight year period at an average rate of 9% per annum. This pushed the tax ratio up to a record 21.2% of GDP (1975/76) (Table 2.1). The source of this relatively fast growth could be found in the contributions from company tax, individual tax and customs and excise returns, which provided 22%, 21%, and 18% respectively to the growth in total revenue. The new addition to the tax system, sales duty, provided 7% of this growth, as did mining companies.

In the composition of revenues, two major changes were observed namely; growth in the share of mining revenue from 10% to 17% (following the rise in the price of gold from R41 to R161 over this period), and a rise in sales duty's share from zero to 4% (Table 2.2 and Table 2.3).

2.6 1976/77 - 1985/86

The last period under consideration, was once again characterised by significant tax reform measures. Policy initiatives included: the abolition of the dual budgetary system, the introduction of General Sales Tax (GST), the phasing out of separate taxation for Blacks, as well as the incorporation of a detailed Fringe Benefits tax. These all reflected the government's desire to modify the tax structure to suite a rapidly changing economic environment and rising expenditure requirements.

The first major innovation of this period (1976) took the form of a change to the established budgetary procedure of Central government. Finally following a recommendation of the Franzsen Commission, the Consolidated Revenue Fund, in existence since 1909, was replaced by a single unitary account, the State Revenue Fund.

Unlike the Consolidated Fund, which distinguished between the Loan and Revenue accounts (roughly financed from loans and current revenue respectively), the new Revenue Fund merged both into a single unitary statement, effectively eliminating the need for separate financing.

There were two major reasons for the abolition of the Consolidated Fund. The first was the problem the government had in deciding which revenue sources should be used for the financing of capital expenditure and which for current. The lack of clarity in this regard often resulted in revenue from the Loan account being used to finance current expenditure and vice-versa. A good example was the case of Transfer duty which between the period 1966 and 1972 was used to help finance capital expenditure.

Secondly, the frequent use of the end of year surplus on the Revenue Account to off-set loan commitments in the Loan Account for the following year, had often led to opposition from organisations which had expected these end of year surpluses to be returned in the form of tax relief.

With the merging of these two accounts, aimed at giving 'a more meaningful picture of the State finances', both problems were effectively disposed of. As will be discussed later (Chapter

5), the Revenue Fund also provided government with considerably more freedom in tax policy.

The second major innovation of 1976 was a major change to the schedule of tax rates. The company tax rate was raised from 43% to 49% (inclusive of the loan levy).

In July 1978, possibly the most significant tax policy innovation to occur in the whole period, came with the introduction of General Sales Tax. Following a recommendation of the Standing Commission on tax policy, it marked the beginning of what Finance Minister Horwood claimed to be the 'start.....of a major tax reform programme'. In some respects, it also claims the distinction of being the only major addition to the tax structure in the post-war period.

The rationale given for the introduction of GST, payable on all purchases not designed for resale or processing, was in the perceived need to broaden and extend the total tax base as a result of growing expenditure requirements. It was also intended that GST would provide the revenue required for individual income tax cuts and play a role as a suitable instrument of fiscal policy. Most importantly though, it once again underlined the government's oft stated intention to equalise its reliance on indirect and direct taxation in the true Gladstonian sense.

Initially, it was hoped that since GST was a tax on consumption expenditures, revenue from it would grow automatically, thereby eliminating the need for frequent discretionary action. It was thus originally intended that the rate be kept as 'low as

possible'. As Finance Minister Horwood remarked:

"...the most important consideration for the establishment of the proposed broadly based final-point-of-sale general sales tax is to create a viable indirect tax which will as consumption expenditures increase, maintain a natural growth in revenue without necessarily having to increase the rate of taxation."

(Hansard, 1978, March, c.3375).

In later years however, due to rising expenditure requirements, as well as attempts to use GST as an instrument of demand management, the rate was raised on five separate occasions from 4% to 12%. This represented a threefold increase in only seven years. The trend is presented below:

DATE	RATE
3 July 1978	4%
1 March 1982	5%
1 September 1982	6%
1 February 1984	7%
1 July 1984	10% ⁷
25 March 1985	12%

Source: Income Tax Reporter, April 1985:62

Over the same period (i.e., 1977-1980), the tax system was again used as a means of protecting and improving the Balance of Payments as had been done on a number of occasions before (e.g., 1960-63). Operating within its commitment to GATT, the government introduced an import surcharge at a rate of 15% in 1977. In 1978 this was scaled down to 12,5% and again to 7,5% in 1979. In 1980, it was abolished, only to be reintroduced in 1982 at 10%.

In 1980, following two years of individual concessions (which saw the maximum marginal rate fall from 72% to 60%), three more significant changes were made to individual taxation. The first was the abolition of the separate tax tables for married and

unmarried persons. A second innovation was the reintroduction of rebates as had been the case prior to 1972 and the scrapping of the abatement system. A last change, was yet another reduction in the maximum marginal rate from 60% to 50% and the raising of the level at which it became payable from R30 000 to R40 000 for married persons, and from R22 000 to R28 000 for single persons.

This rationalisation period continued through into 1981, with the introduction of the final PAYE deduction scheme.

The basic idea of the final deduction scheme was that for persons earning R7 000 or less per annum (mainly in the form of salaries and wages), there was no longer any necessity of rendering an income tax return. In practice, this meant that for persons earning R7 000 or less, PAYE deductions throughout the year served as full settlement of their tax liability. This innovation was aimed at reducing the work load for the Department of Inland Revenue by eliminating thousands of annual tax assessments. In 1983, the income figure was raised to R8 000.

The period 1978 to 1984 also witnessed a number of changes to the system of Black taxation.

Prior to the passing of the Black Taxation Act of 1969, there had only been one significant modification (in 1958) to the 1925 Native Taxation and Development Act. This adjustment saw the rise in the basic poll tax to R3,50 and the introduction of a graduated income tax for incomes in excess of R360 p.a..

A separate tax system was continued for Blacks with the passing of the Black Taxation Act of 1969. Although this Act reduced the basic poll tax from R3,50 to R2,50, it also introduced a new schedule of rates. Under this new system, Blacks were subject to tax at income levels that under the 1962 'White' Act would have remained tax free. It also differed in regard to the treatment of spouses, and did not contain provisions for rebates, allowances or deductions that were obtainable under the 1962 Act.

In 1978, following the recommendation of an inter-departmental committee on Black taxation (unpublished, see budget 1978) the Minister of Finance announced a three phase programme aimed at the equalisation of tax obligations for Blacks and Whites.

The first phase took place in 1979, when the rate at which Blacks became liable for tax was raised from R361 to R1201. In 1980, a further step was taken and the level was raised further to R1800. At the same time, the average tax rate was reduced by 20%. In 1983, the final step was taken and discrimination in income tax matters was finally abolished. Beginning March 1983, all Blacks became liable under the general Income Tax Act of 1962.

The effect of this last change was to lower the effective tax bills of Blacks earning R6 000 or more substantially, whilst maintaining the status quo for others (McGlashan, 1984).

Announcing the change in the Budget speech of that year, the Minister of Finance said of it:

" It is fair, I feel, that all South Africans irrespective of race or colour, be taxed in terms of the same Income Tax Act, and at the same time enjoy the concessions, deductions and rebates.....the new procedure represents a significant step forward in our fiscal laws and administration."
(Hansard, 1983, Vol.106, c.4201).

In 1984, the Standing Commission on tax policy was instructed to investigate and report on the system of initial and investment allowances in the industrial sector (W.P.H./ 1983).

The chief finding of this enquiry was that the investment allowance, which had been used intermittently in the past, was open to serious abuse. As such the Commission did not believe that it acted as an incentive to investment. They further argued that it had a very limited role to play as an instrument of anti-cyclical policy.

The government accepted the findings of this Commission, and announced the discontinuation from 1986 of the investment allowance. In its place, the government accepted the alternative proposition i.e., that the extension of accelerated depreciation allowance be through the initial allowance, which in turn was raised from 20% to 55% of original cost.

Perhaps the last significant innovation to the South African tax structure to occur in the whole period under review, came with the introduction in 1985, of the Fringe Benefits tax.

Always a contentious issue, the fringe benefits tax had involved at least fourteen years of protracted negotiation between

government and organised commerce and industry. Finally, following the report of a select Commission of Enquiry (R.P. 64/1983), fringe benefits taxation became law in March 1985.

Comprising the the new Seventh Schedule of the 1962 Income Tax Act, the fringe benefits tax comprises a set of uniform rules to be used in the determination of benefits for inclusion in taxable income. Some of these benefits include; motor vehicle allowances, subsidized housing loans and other indirect privileges. Since their introduction some of the more severe aspects of the tax have been eased.

Another significant feature of this period was the near equalisation of the maximum marginal rate of tax payable by individuals and companies. Over the period 1977 to 1985, individual rates followed a downward trend to 50% (excluding the loan levy), whilst company tax rates rose to 50% over the same period. During these eight years, the level at which the maximum marginal rate had become payable rose to R60 000 (for married persons).

Despite these policy initiatives, this same eight year period did not see much of a rise in the tax ratio, which remained fairly stable in a range between 19% and 23% of GDP. This reflected an average real growth rate of around 4,0% per annum.

The composition of revenue collections on the other hand, underwent considerable change, mainly as a result of the incorporation of GST. This latter source, which accounted for only 4% of total revenue collections in the year in which it was introduced, had by 1985 increased its share to 26%. This made

GST the second most valuable source of revenue for government after individual income tax, which increased its share from 24% to 32% over the same period. The shares of customs, excise and company tax reflected the growth in these sources and all fell in relative importance. A notable exception was the variable trend in the share of mining revenue which, reflecting the world price of gold, fell from a peak of 28.7% in 1980, to 9.6% in 1985.

Fiscal Year Ending	Total Ordinary Revenue (R m)	As a % Of G.D.P.
1946/47	214	13.1
1947/48	225	12.4
1948/49	250	12.5
1949/50	260	11.9
1950/51	279	10.9
1951/52	353	12.7
1952/53	389	13.1
1953/54	442	13.2
1954/55	456	12.6
1955/56	481	12.7
1956/57	516	12.5
1957/58	527	12.1
1958/59	551	12.4
1959/60	589	12.5
1960/61	620	12.4
1961/62	623	11.7
1962/63	701	12.4
1963/64	842	13.4
1964/65	958	13.9
1965/66	1063	14.1
1966/67	1174	14.3
1967/68	1343	14.6
1968/69	1659	16.8
1969/70	1941	17.6
1970/71	2257	18.7
1971/72	2576	19.4
1972/73	3053	20.3
1973/74	3958	21.2
1974/75	4808	20.8
1975/76	5487	21.2
1976/77	6050	20.9
1977/78	6749	21.2
1978/79	8184	22.2
1979/80	9827	22.3
1980/81	13349	23.3
1981/82	14671	22.7
1982/83	17422	24.1
1983/84	19335	23.7
1984/85	24085	24.9
1985/86	26880	23.9

Source: Table A, Column 17
GDP at factor cost

TABLE 2.1 CENTRAL GOVERNMENT ORDINARY REVENUE COLLECTIONS, IN MILLIONS, AND AS A PERCENTAGE OF G.D.P., 1946-1985.

PERIOD	CUSTOMS DUTY	EXCISE DUTY	COMPANY TAX	INDI'UAL TAX	GOLD MINES	OTHER MINES	SALES D G.S.T.	GOLD LEASES	NRST	STAMP D & FEES	TRNSR DUTY	ESTATE DUTY	INTST & DIV	OTHER	TOTAL
1946-49	18.4	15.9	11.5	24.3	7.1	1.4	-	0.5	1.6	3.2	2.7	1.3	3.6	8.5	100
1950-53	11.1	14.1	15.8	25.4	9.8	3.3	-	1.0	1.9	2.2	2.7	0.8	3.7	8.2	100
1954-57	12.7	15.1	23.0	21.5	5.8	3.6	-	0.8	2.1	2.1	2.5	0.7	3.6	6.3	100
1958-61	13.9	19.2	20.3	17.3	8.6	2.9	-	1.8	1.9	2.1	1.9	0.8	4.8	4.4	100
1962-65	11.7	18.7	22.3	17.5	10.1	2.3	-	3.4	1.4	2.0	1.9	1.1	4.5	3.1	100
1966-69	9.3	17.8	24.3	18.6	6.1	3.0	1.2	2.3	1.7	2.0	1.9	1.5	4.4	5.9	100
1970-73	7.1	14.1	24.8	22.7	5.4	2.0	5.9	1.8	1.4	1.9	1.8	1.0	7.3	2.8	100
1974-77	6.6	12.2	25.1	25.7	7.6	1.4	4.3	2.6	1.5	1.4	1.0	0.7	7.4	2.6	100
1978-81	4.0	10.4	19.2	20.3	12.8	1.7	12.2	4.0	1.8	1.1	1.0	0.5	5.6	5.2	100
1982-85	2.5	8.2	17.4	29.2	7.5	1.0	22.3	2.0	1.1	1.0	1.2	0.4	2.5	3.7	100
AVERAGE	9.7	14.6	20.4	22.3	8.1	2.3	4.6	2.0	1.6	1.9	1.9	0.9	4.7	5.7	100

Source:Table A.

TABLE 2.2 THE COMPOSITION OF CENTRAL GOVERNMENT ORDINARY REVENUE, BY SOURCE, IN FOUR YEARLY AVERAGES, 1946 - 85.

PERIOD	CUSTOMS & EXCISE	COMPANY	IND'UAL	MINING	SALES D & G.S.T.	OTHER	TOTAL
1946-49	34.2	11.5	24.3	9.1	-	20.8	100
1950-53	25.3	15.8	25.4	13.9	-	19.5	100
1954-57	27.9	23.0	21.5	10.3	-	17.3	100
1958-61	33.2	20.3	17.3	13.2	-	15.9	100
1962-65	30.4	22.3	17.5	15.8	-	13.9	100
1966-69	26.1	24.6	18.6	11.6	1.2	17.5	100
1970-73	21.2	24.8	22.7	9.2	5.9	16.3	100
1974-77	18.8	25.1	25.7	11.6	4.3	14.5	100
1978-81	14.4	19.2	20.3	18.6	12.2	15.3	100
1982-85	10.7	17.4	29.2	10.5	22.3	9.9	100
AVERAGE	24.2	20.4	22.3	12.4	4.6	16.1	100

Source: Table A

TABLE 2.3 THE COMPOSITION OF CENTRAL GOVERNMENT ORDINARY REVENUE, BY MAJOR SOURCE, IN FOUR YEARLY AVERAGES, 1946-1985.

PERIOD	DIRECT	INDIRECT	OTHER
1946-49	49.9	39.7	10.4
1950-53	60.2	30.0	9.8
1954-57	59.8	32.4	7.8
1958-61	55.9	37.1	7.0
1962-65	58.4	34.0	7.6
1966-69	57.9	32.3	9.9
1970-73	64.1	30.1	5.8
1974-77	68.9	25.5	5.6
1978-81	61.5	28.8	9.7
1982-85	58.9	35.0	6.1

Source: Table A
division fnt. 8

TABLE 2.4 DIRECT, INDIRECT AND OTHER TAXES, 1946-85.

PART THREE: INTERPRETATION

CHAPTER THREE: EVALUATING THE ECONOMIC DEVELOPMENT APPROACH

3.1 Introduction

The economic development approach to tax structure change emphasizes the role that economic development plays in the evolution of tax structures over time. Essentially, this approach is based on the premise that economic development is the most important factor influencing the size and composition of revenue collections through its effects on tax bases, tax 'handles', taxable capacity and the costs of collection.

The object of this chapter is the evaluation of this approach with reference to the South African experience over the past forty years. In the process major changes to the abovementioned mechanisms will be explored.

The chapter is divided into five main sections, the last four of which deal specifically with assessing different aspects of the economic development approach. The first section, in order to put the whole analysis into an appropriate historical perspective, consists of a brief descriptive overview of key economic development patterns. Thereafter, sections B and C each comprise an examination of the effect that these development trends have had on the size and composition of revenues. Section D follows with an investigation into the role that economic development has had on discretionary action, and on the extent to which it has restricted the range of choices available to taxing authorities. Lastly, section E considers the relevance over

time of the cost of collection argument.

3.2 South African Economic Development Patterns (1946-1985)

Table 3.1 briefly summarizes the historical variation in a few key indicators of economic development considered relevant to this study (see, Nattrass, 1981:23-32; Kantor and Rees, 1982:4-35; Houghton, 1973:7-18). A number of major trends are readily identifiable, each of which has had important implications for the development of the South African tax structure.

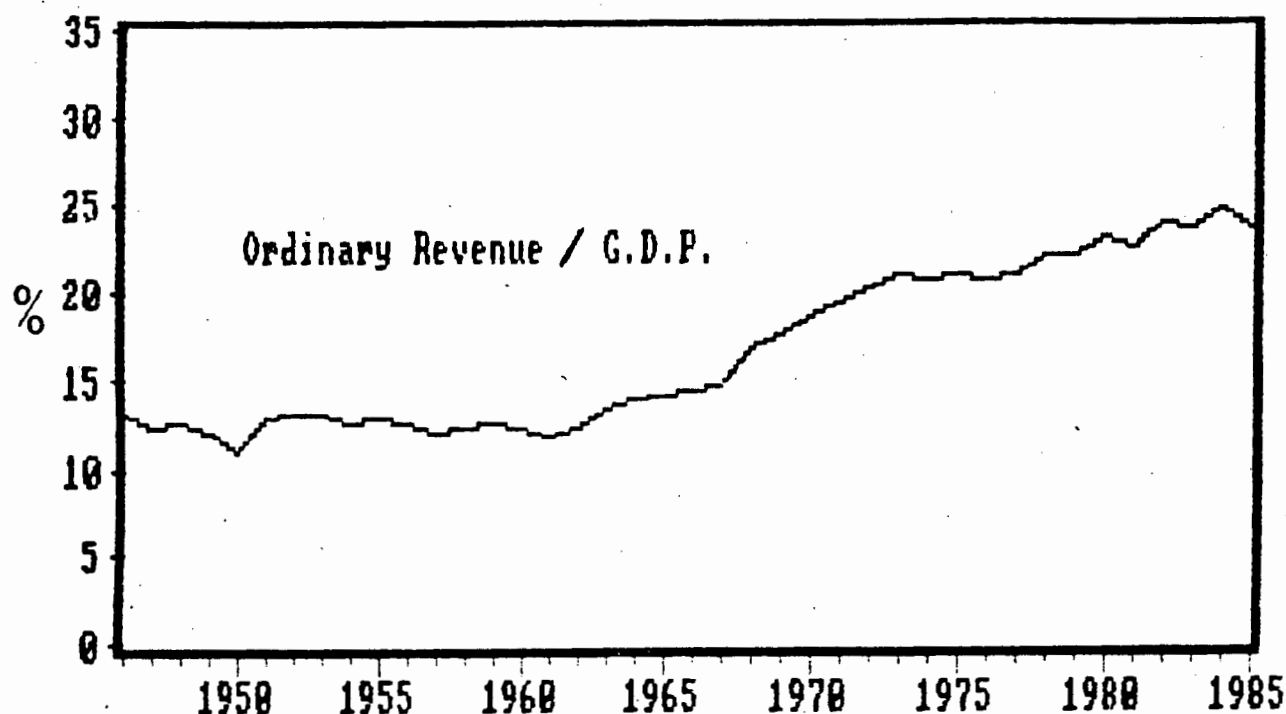
Firstly, the primary sector's share of total economic activity has declined considerably since the late 'forties, when it averaged 27% of GDP, to approximately 20% today. This decline is a priori expected as countries develop. In S. Africa it is mainly attributable to the low rates of growth experienced in primary industries (other than mining), relative to growth rates in the more productive sectors of the economy. The agricultural, fishing and forestry sectors, which accounted for some 15% of GDP in the immediate post-war period, today constitute only 5% of total economic activity. On the other hand, the trend in mining's share, after initially declining between 1940 and 1970, has subsequently been moving gradually upward reflecting the world price of gold. Undoubtedly, were it not for the important role that gold plays in the international economy, this sector's decline would probably have been more in line with that of the rest of the primary sector, as has been the experience elsewhere.

A second major trend is evident in the expansion of secondary sector activity, in particular manufacturing. This latter sub-

PERIOD	TAX RATIO	PER CAP INCOME	OPENNESS (X+M/GDP)	SECTORAL COMPOSITION OF GDP (%)						
				MIN	AGR	SEC	TER	GOV	OTH	TOT
1946-49	11.1	518	44.1	10.7	15.3	21.6	38.3	9.7	4.4	100
1950-53	11.5	558	49.0	10.3	15.2	22.8	40.5	7.0	4.2	100
1954-57	11.6	616	41.9	12.1	13.5	24.4	38.0	7.9	4.1	100
1958-61	11.5	658	35.6	12.6	11.8	24.6	38.6	8.4	4.0	100
1962-65	12.1	725	34.1	11.8	10.2	26.8	39.0	8.6	3.6	100
1966-69	14.0	853	32.1	10.2	9.1	27.3	41.3	8.8	3.3	100
1970-73	16.5	934	32.3	10.5	8.3	27.5	40.9	9.7	3.1	100
1974-77	18.2	974	38.9	12.3	7.4	28.5	39.2	9.8	2.8	100
1978-81	18.7	985	38.7	16.4	6.3	27.9	37.8	9.3	2.3	100
1982-85	20.0	1035	25.7	13.4	4.2	28.3	40.4	11.5	2.2	100

SA Stats (Tables 21.4-21.10)

TABLE 3.1 KEY INDICATORS OF ECONOMIC DEVELOPMENT PATTERNS, IN FOUR YEARLY AVERAGES, 1946 TO 1985



Source: Table 2.1

FIGURE 3.1 CENTRAL GOVERNMENT ORDINARY REVENUE COLLECTIONS, AS A SHARE OF GDP, 1946/47 TO 1985/86

sector, which comprised only 22% of GDP in the late 'forties, accounted for 28%-30% of GDP in the late 'sixties. Since then, the expansionary trend in this sector has continued but at a much slower rate.

A third major trend is evident in the tertiary and general government sectors. Both have preserved fairly constant shares of GDP over the whole period, despite widely held contrary belief in the case of the latter.

Two major tendencies are identifiable in the foreign trade sector. Firstly, the size of the trade sector, measured as a share of total domestic activity ($X+M/GDP$), has generally fallen with economic development i.e., the S. African economy has become much less 'open'. Secondly, this sector has diversified out of exports of primary commodities increasing its trade in manufactures. Gold exports have, however, remained a major exception. Unlike other primary exports, gold has retained its dominant status as the country's principal export commodity and source of foreign exchange (see Kantor and Rees, 1982:5).

Real per capita incomes have experienced a degree of variation in the past forty years. A first phase lasted for the thirty five year period ending 1981, during which real per capita income grew at an average rate of approximately 2% per annum. This was despite a relatively high population growth rate of 2,3% p.a. (incl. 'homelands'). Since 1981, however, real per capita incomes first stagnated and have more recently begun to decline.

The overall racial distribution of this income (as will be dis-

cussed later) has also changed. The general consensus suggests that the White group's share of income, which remained fairly stable at approx. 70% up until the late 'sixties/early 'seventies, has since fallen, indicating a move toward greater equality for Blacks and Whites (Devereaux, 1983:35; McGrath, 1985:7).

S. Africa's current level of per capita income also helps one identify the country's present stage of economic development. With a per capita income level of around one fifth of that of the US, but equal to Chile, Yugoslavia and Brazil, this would be in a position 'midway between the developed economies and those which are undeveloped' (McGrath, 1985:3). This is also the broad category into which S. Africa is placed by the IMF (see IMF Government Financial Statistics, 1984:26).

A considerable degree of variation is also evident in the size of Central government ordinary revenue collections (see Table 2.1). Measured as a percentage of GDP, the tax ratio or tax 'burden' has risen from 13,1% to 23,9% over the whole period concerned. This reflects an average annual real growth rate of some 4.5%, marginally higher than the corresponding rate of growth in GDP. In addition, no one source of revenue can be identified as the sole cause of this expansion.

It is further evident from Figure 3.1, that tax ratio growth occurred in three distinct phases or cycles. The first phase lasted approximately 16 years between 1946 and 1962, during which the tax ratio remained at a constant 11 to 13%. This reflected a real growth rate of around 4,1% p.a.. The second phase falls over the following sixteen years (until 1979), when

the tax ratio experienced its fastest growth rising from 12,4% to 21,2% in almost yearly increments. This amounted to a relatively higher growth rate of around 8,6% p.a.. The third phase lies in the last 8 to 9 years, in which the tax ratio once again levelled out, at around 21 to 24%, reflecting the growth rate of GDP over this period of around 4.2% p.a..

In terms of present day tax revenues, therefore, S. Africa would fall into a group with such high income developing countries as Malaysia and Tunisia (see Newlyn, 1985:394), but still well below highly developed industrialized countries such as the OECD states, Japan or the USA (See Heald, 1983:30).¹

To a large extent, S. Africa's pattern of economic development, if viewed broadly over time, reflects the so-called general 'patterns of growth' identified by Chenery and Syrquin (1975). The primary sector's share has fallen, and this has been replaced by secondary and tertiary sector activity. Real per capita incomes have grown and become more evenly distributed. There has also been a rise in the capital stock relative to labour (Biggs, 1982). Lastly, there has been a significant rise in the Central government's tax ratio and hence greater government involvement in the economy. Indeed, according to at least one study, 'the structure of the South African economy is in many respects similar to....(these)...international norms....' (Kantor and Rees, 1982:8)².

To sum up: over the forty year period under review, S. Africa has evolved from a low-income into a high-income developing country. This has been in a fashion not inconsistent with that of other

countries experiencing similar patterns of development. As will be shown, this transformation has had implications for the evolution of the tax structure, the most important of which are discussed below.

3.3 The Tax Ratio and Economic Development

Central to the economic development approach is the relationship between taxable capacity and total revenue collections. Briefly, this hypothesis maintains that during the course of economic development, the size of the tax ratio is expected to rise pari-passu with the expansion in taxable capacity (Radian, 1980:30).

In the cross-sectional studies reviewed earlier, it was further argued that taxable capacity, and hence the size of the tax ratio, could be 'explained' by regressing the tax ratio on a number of variables which serve as proxies for taxable surplus (ability to pay) and the availability of tax 'handles' (ability to collect). Undertaking a similar investigation using local data, is, therefore, a means of evaluating the degree to which these variables 'explain' the pattern of growth in the S. African tax ratio. In a more general sense, such a study also enables one to determine the extent to which hypotheses derived from foreign cross-sectional analyses can be used to infer trends in an individual country.

1) Methodology

Following Tait et al (1979), the most important factors which can

be expected to influence the size of the tax ratio via taxable capacity effects are;

- a) The share of foreign trade in total production
- b) The sectoral composition of GDP
- c) The size of the average business unit
- d) The level of business sophistication and monetization
- e) The literacy level

From this,

$$T/GDP = f(A)$$

where:-

T/GDP = the size of the tax ratio

A = proxies for the availability of tax 'handles' and surplus.

Factor a, can be represented by either $(X+M)/Y$, X/Y or M/Y , where X = exports (manufactured goods), M = imports, and Y = GDP, i.e., three versions of the 'degree of openness' (Hinrichs, 1966). Factor b, would include the share of agriculture (Ag) and mining (Min) in GDP (Chelliah, 1971). Factors c through e are all traditionally represented by real per capita income (Y_n).

From this we can derive a functional relationship:

$$T/GDP = f(X+M/Y, X/Y, M/Y, Ag, Min, Y_n \dots \dots)$$

Testing this equation in a multiple regression form, however, provides results of dubious validity owing to the high (and expected) levels of multicollinearity which exist between the explanatory variables. (This is also the case when testing the

equation in a shortened form: $T/GDP = f(X+M/Y Ag, Yn)$ ³. Instead, following Mann (1980), who employed a similar technique, the approach adopted here is to test for the significance of each of these variables separately. The advantage of this method is that although the insight gained from a total equation is lacking, the relationship between each variable and the tax ratio as predicted by earlier studies can be clearly identified, even though the causality may not be clear. This has been the approach used in other studies (e.g., Thac and Lim, 1984).

Before presenting these results, three general points should be stressed. Firstly, the primary emphasis is on testing the significance of variables which have been identified by others in similar studies. These, however, are not exhaustive, and cannot, therefore, be expected to explain all variations in T/GDP given the multitude of factors involved. Secondly, since few new taxes have in fact been added to the tax system over the period under review, the regression equations have tended to capture the 'surplus' effects (generated by increased taxable capacity) and the effects of discretionary changes to established taxes, rather than the effect of revenue contributions from new tax additions. Lastly, while the regression approach adopted here reflects current research methodology (e.g., Mann, 1980), this itself is characterized by deficiencies.⁴

ii) Regression Results (Table 3.2)

Equations 1 to 3, relate to per capita income for the whole period 1946-85, as well as to the two sub-periods 1946-65 and

EQUATION	PERIOD		DW	R ²
1.	1946-85	T/GDP = -0.02 + 0.0002 Yn (-2.5) (14.7)	1.26	.85
2.	1946-65	T/GDP = -0.10 + 0.0004 Yn (-10.0) (2.8)	1.16	.38
3.	1965-85	T/GDP = -0.23 + 0.0005 Yn (-6.3) (12.1)	1.64	.88
4.	1946-85	T/GDP = +0.23 - 0.34 M/GDP (6.5) (-2.2)	1.21	.11
5.	1946-65	T/GDP = +0.14 - 0.09 M/GDP (14.4) (-2.1)	1.31	.16
6.	1965-85	T/GDP = +0.18 - 0.10 M/GDP (3.6) (-1.6)	1.24	.12
7.	1946-85	T/GDP = +0.26 - 0.53 X/GDP (7.8) (-2.8)	1.36	.16
8.	1946-65	T/GDP = +0.13 - 0.24 X/GDP (16.5) (-2.1)	1.00	.17
9.	1965-85	T/GDP = +0.19 - 0.31 X/GDP (4.3) (-2.4)	1.13	.22
10.	1946-85	T/GDP = +0.30 - 0.31 M+X/GDP (7.2) (-3.1)	1.24	.20
11.	1946-65	T/GDP = +0.14 - 0.20 M+X/GDP (11.9) (-2.0)	1.15	.22
12.	1965-85	T/GDP = +0.19 - 0.25 M+X/GDP (16.2) (-2.2)	1.17	.18
13.	1946-85	T/GDP = +0.29 - 1.08 Ag (28.6) (-12.6)	1.50	.81
14.	1946-65	T/GDP = +0.14 - 0.17 Ag (16.1) (-2.6)	1.30	.44
15.	1965-85	T/GDP = +0.33 - 0.57 Ag (21.8) (-8.6)	1.43	.78
16.	1946-85	T/GDP = +0.07 + 0.79 Min (2.4) (2.6)	1.21	.16
17.	1946-65	T/GDP = +0.14 + 0.46 Min (7.0) (2.8)	1.13	.21
18.	1965-85	T/GDP = +0.13 + 0.55 Min (4.5) (2.6)	1.32	.26

All coefficients significant at the 95% level.

TABLE 3.2 REGRESSION EQUATIONS FOR ECONOMIC DEVELOPMENT AND TAX RATIOS (1946-85).

1965-85. In this regard, a positive sign on the Y_n regression coefficient is a priori expected, since higher real income levels enable the taxing authorities to realize part of the growing taxable capacity in the form of higher tax returns.

The results achieved appear to confirm this. From the first three equations, it can be seen that the tax ratio (T/GDP) is directly and significantly associated with per capita income, which 'explains' some 85%, 38% and 88% of the variation in T/GDP over the three periods respectively.

Of particular interest though, is the marked difference which emerges in the explanatory power of per capita income (in terms of R^2) for the two sub-periods 1946 to 1965 and 1965 to 1985. In the first sub-period (1946-65), although real per capita income increased by some 61%, the tax ratio measured over the same twenty year period rose only marginally. In contrast, in the second twenty year period (1965-85), when real per capita income rose by only 30%, the tax ratio rose markedly from 14% to 23%. (This is confirmed in a Chow test: $F^* = 690$, $F_{0.05} = 3.23$. Since $F^* > F$ crit, then the two relationships differ at 95% confidence)

Although, undoubtedly a whole host of other factors played a role (e.g., increased urbanization), it is also very likely that part of the answer to this anomaly lies in the actual variation in the distribution of income, as highlighted earlier (Afxentiou, 1980:131).

In the first period, at least up until the late 'sixties, the distribution of income, as measured by the Gini coefficient,

remained fairly constant at around ,71. In the second period, corresponding with the rise in the tax ratio, this coefficient fell to ,65 (1976) and again further to ,57 (1980) (Devereaux, 1983:35). At the same time there was also a marked trend towards equalization in the racial distribution of income (McGrath, 1985:5-6).

Although difficult to test empirically (i.e., due to absence of time series of Gini coefficients), this apparent association has important implications for understanding the S. African experience. In short, it may be the case that it is the actual distribution of income, rather than simply growth in per capita income, which plays the more significant role in determining the size of revenue collections. This would confirm the notion that a rising per capita income is not a sufficient prerequisite for rising taxable capacity, especially if the growth is concentrated in the high income groups (who are taxed at high rates already and who are strongly geared for evasion), or if it only reflects a rise in subsistence income. The demand side is also important here, since a rise in per capita income is also a powerful argument in the demand for government expenditures as postulated by Wagner, limited support for which is evident in at least two studies done on South Africa (Abedian and Standish, 1984; Seeber and Dockel, 1978)⁵.

Equations 4 to 12 deal with the 'degree of openness'. In this regard, any number of combinations of X/GDP , M/GDP and $X+M/GDP$ have been used as proxies for taxable capacity in a number of studies. Here, for reasons explained earlier, one would expect that in developing countries, the tax ratio will be positively

related to increases in the size of the foreign trade sector.

Quite different results were obtained for S. Africa. Whilst almost all three versions of this variable were found to be statistically significant, the sign on the beta coefficient was in all cases opposite to our a priori expectation. The results imply that as the economy became less 'open', taxable capacity grew and with it the size of the tax ratio.

Two possible explanations exist. The first is that the results obtained simply indicate that the S. African tax structure, although relatively unsophisticated by developed country standards, is still nevertheless in advance of those developing countries which rely heavily on the foreign trade sector for tax earnings, and from which this hypothesis was derived. This explanation would also lead to the conclusion that the 'degree of openness' variable has very little explanatory power for the S. African experience.

A second explanation, would argue that the results achieved are mildly plausible given the nature of the economy and the Republic's stated policy of import substitution, at least up until the early 'seventies.

Although the argument may be a little strained, this explanation rests on the premise that much more surplus is made available for taxation if production is undertaken domestically than is the case if goods are simply imported. Certainly, following a process of import substitution the returns from trade taxes would fall. But, if the production, distribution and consumption of

locally made goods is exposed to more tax points than does importation, than the loss would be more than offset. Thus, as Lombard notes:

"..... the expansion and structural changes of economic activities since 1950, the increasing problems of the gold mining industry and the policy of import replacement led, inter-alia, to a marked increase in the revenue from company tax over the whole period."

(Lombard, et al, 1971, p.6, emphasis added).

The sectoral composition variables were examined next and are presented in equations 13 to 18. These structural variables reflect the availability of taxable surplus and tax 'handles', as well as showing, to a limited extent, the contribution that different sectors have made to the growth in T/GDP. As discussed earlier, the general argument is that the tax ratio is negatively related to growth in the rural sector, but positively related to growth in mining.

As indices of structural change, agriculture's share in GDP (Ag) is possibly the more commonly used. In the case of S. Africa, the results obtained re-emphasize the applicability of this measure. Equations 13 to 15 reveal that the consistent decline in the primary sector (Ag) since the 'forties, serves to explain some 81%, 44% and 78% of the variation in the tax ratio over the whole period and two sub-periods respectively. Put another way, the relative decline in agriculture's contribution has opened up a host of other more productive bases. In addition, these bases are more easily controlled from both an administrative and political point of view. The growth in these bases has thus manifested itself in increased revenue collections.

Support for the significance of the share of mining in GDP, the second most commonly used structural indicator of taxable capacity, is also evident. Equations 16 to 18 indicate that the share of the mining sector (Min), for the whole period, as well as for the two sub-periods, is a significant variable associated with growth in T/GDP.

Surprisingly though, even after taking into account the effects of the gold price and exchange rate variability, the explanatory power of Min in terms of R^2 (16%, 21%, and 26%) is possibly lower than might have been expected. Ease of collection, a high 'willingness' to tax this sector more heavily than others, as well as a history of variable tax contributions from this source, would at least on the surface, point in the direction of a stronger statistical relationship.

Whilst other factors play a role, especially those associated with the tax formula and lags in tax payments, part of the reason for this anomaly may be found in the deficiencies associated with the generally accepted method of calculating the contribution of the gold mining sector in the National Accounts. According to one study, the method employed by the compilers of the statistics has led to a 'consistent underestimation of the value added of the mining sector' (Abedian and Kantor, 1985:11). As a result, it is quite likely that the regression equation suffers from this measurement error.

The results of Table 3.2 can be summarized as follows; Firstly, per capita income is a direct and significant determinant of the tax ratio for all periods considered, although the distribution

of income also appears to have played a complementary role. Secondly, although the degree of 'openness' cannot be completely ruled out as a possible explanatory variable (i.e., due to the significant coefficients), in terms of the theory presented (i.e., the sign), it is more likely that it is not a significant element associated with the dependant variable, irrespective of the time periods or variation used. Thirdly, both the primary sector share (Ag) and the mining share (Min) are directly and significantly associated with variations in T/GDP, for the whole period, as well as for the two sub-periods.

3.4 The Composition of Taxes and Economic Development

The economic development approach attributes variations in the composition of revenue collections over time, to two separate, yet highly inter-related factors. Firstly, there are variations which occur 'automatically' during the course of economic development as a result of elasticity factors i.e., changes in revenue shares which can be associated with a given set of tax rates and tax instruments. Secondly, there are variations which have their origins in tax policy or government discretionary action. In the case of the economic development approach, these would consist primarily of government decisions to introduce additional tax instruments as a result of rising expenditure requirements. (Changes in tax rates on the other hand, are clearly not a feature of economic development per se and here the theory has little to offer).

An investigation into the extent to which predictable trends have been manifested in the pattern of Central Government revenue

collections is, therefore, one possible way of evaluating the applicability of this aspect of the economic development approach. The elasticity and discretionary aspects are each examined separately below.

1) Elasticity factors

The elasticity of the tax system as a whole, or of a single tax instrument, can be separated into two major elements; tax to base and base to income elasticities. The former refer to variations in tax revenues associated with growth in the tax base (i.e., tax 'yield'), whilst the latter refer to changes brought about by actual tax base growth relative to the growth in GDP.⁶

Whilst the tax to base constituent can often be influenced favourably through more efficient administration, the more dominant component, and the one on which attention is focused, is the base to income elasticity. This is exogenous to the system and 'lies outside the control of authorities.....largely determined by the way the structure of the economy changes with economic growth' (Mansfield, 1972:427).

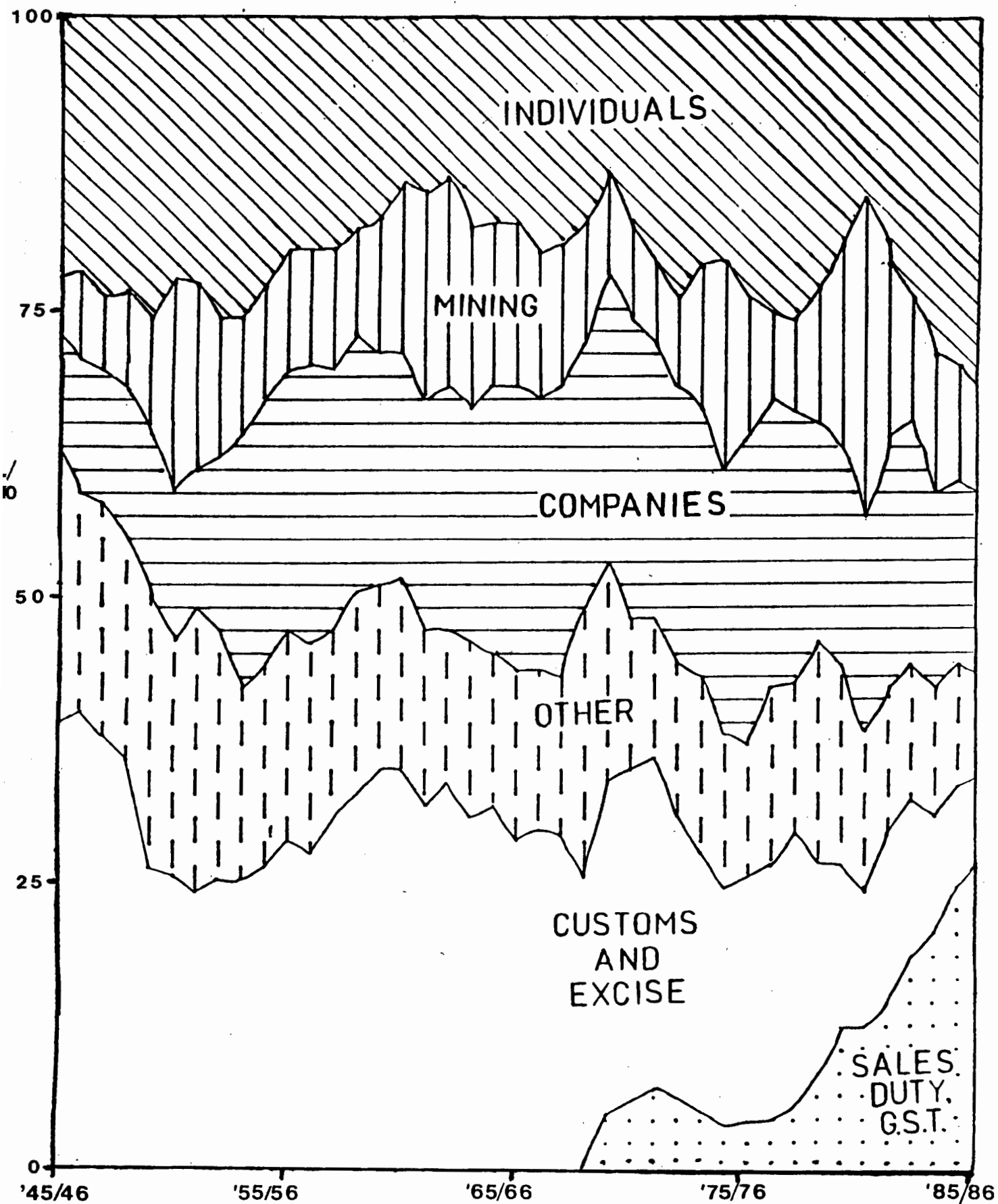
Admittedly, changes in rates also play a role. But, if the base to income elasticity component of a tax source is low, as is the case with say, customs duties, then only continual discretionary action via the raising of tax rates or through the extensions of the definition of the tax base can ensure that tax returns from a particular tax source are maintained at a constant share of the total. In most cases though, continual discretionary adjustments of this type are rare or ineffective given the economic

constraints and political costs associated with frequent tax hikes. As a result, over time, the relative shares of total revenue collections tend to reflect the behaviour of the various base to income elasticities of the major tax sources. For example, during the 'later' stages of economic growth, the bases for most internal sales taxes and personal income tax tend to grow at a rate faster than the corresponding rate of growth in GDP, as is the case (to a lesser extent) with company tax (Goode, 1984:83). It follows, therefore, that on the strength of these base to income elasticities, the shares of these taxes in total revenue collections can be expected to rise. On the other hand, the relevant tax bases for customs duties and certain specific rate excise duties expand at a much slower rate and their shares can be expected to fall.

In the case of S. Africa, the variation in the composition of revenue collections (Table 2.2, Table 2.3, Table 2.4 and Figure 3.2) at least up until 1978, is roughly consistent with these patterns.

Firstly, as expected, the share of Customs duty (net of CUA*), a major source of revenue in the pre and immediate post-war period has fallen steadily over the whole period from heights of 18% in the late 'forties, to a mere 2.5% today. This means that after being one of S. Africa's principle revenue sources, customs duty is today on a level with other minor sources such as Transfer and Estate duty.

The fall in customs duty's share, although primarily a feature of its low base to income elasticity, has also been exacerbated



Source: Table A

FIGURE 3.2 THE COMPOSITION OF CENTRAL GOVERNMENT ORDINARY REVENUE COLLECTIONS, BY MAJOR SOURCE, 1945/46 TO 1985/86.

by three additional factors; a) S. Africa's commitment to GATT which limits the scope for tariff policy b) the factors affecting the system of payments to other members of the Customs Union which prejudices S. Africa, c) by the low tax to base elasticities, a feature of the limited number of goods on which these duties can be levied.

A similar, although somewhat less pronounced decline, is also evident in the pattern of excise duties. Considered one of the more valuable sources of revenue up until the late 'seventies (aprox. 15%), it presently comprises only 7% of total revenue collections, despite numerous attempts to raise its share via conversions of specific rate duties to ad valorem charges. In the same way, the shares of other minor tax sources, such as Estate and Transfer duties, have also suffered from relatively low base to income elasticities and have thus also fallen in relative importance over time.

By contrast, the shares of individual and company income tax receipts have risen steadily. In the case of individual income tax, the rise in per capita income, growth in the total wage bill, the expansion of the total tax base, as well as the effects of fiscal drag since 1973, have combined to raise total contributions from this source from aprox. 17% in the early 'sixties, to around 32% today. This reflects an average real growth rate of nearly 9.0% p.a., significantly higher than the growth rates of customs and excise duties which amounted to 4,6% and 4,2% respectively.

A similar trend is also partially evident in the pattern of

company tax receipts, at least up until 1978. Growing at an average rate of some 12% per annum, the contribution from this source had by 1978 risen to 25% from levels of 7% and less in the post-war period. After 1978, however, the returns from this source diminished somewhat largely as a result of two factors. Firstly, the size of the company tax base contracted due to a reduction in the number of individuals using companies as a means of income tax avoidance. This was a result of the near equalization of company and individual tax rates. Secondly, over the last decade, the 'real' company tax rate (as opposed to the statutory rate), for manufacturing companies in particular, has fallen markedly as a result of the broadening of the system of initial and investment allowances (see Chapter 5).

The only notable exception to these trends has been in the pattern of returns from the mining sector, in particular, the gold mines. Unlike the returns from other companies engaged in primary sector activities, which have levelled out or fallen, they have been highly variable (and therefore unpredictable), mirroring the equally variable world price of gold. This variability is especially pronounced in the post-1970 phase, during which revenue from the mining sector varied considerably between 5% and 30% of total revenue contributions.

Consistent with Thorn (1967), the low base to income elasticity of the major indirect tax sources further serves to explain the continued fall in the indirect tax share as a whole. Table 2.4 shows that up until 1978, the relatively low elasticity of indirect taxes resulted in the direct tax share rising throughout the whole period (excl. 1946-49 and 1958-61). This was despite

an attempt to reverse this trend in 1971, with the introduction of sales duty. As Lombard noted at the time:

".....the relatively low elasticity of indirect taxes with respect to income growth has been an important contributing factor in their declining relative importance..(and)... since this is a basic feature of our tax structure, the latter trend is likely to continue unless a restructuring of tax rates is undertaken".

(Lombard, J., 1976, p.3, my emphasis).

In the same study, Lombard estimated bouyancy values for each of the major S. African tax sources for the period 1960 to 1974 and put company tax, personal income tax, excise duties, customs and sales duties at 1.1, 1.2, 0.6, and 0.3 respectively. These results would thus tend to re-emphasize this same point.

Since 1978, however, considerable discretionary action via increases in the GST rate reversed this pattern more successfully than did sales duty - the indirect tax share rose from 25% (1974-77) to 35% (1982-85). With rates currently pitched at 12% though, the likelihood of this trend being maintained in the future is slight, unless additional indirect tax sources are incorporated. Barring this, given the base to income elasticities of the major tax sources, a move toward the increased reliance on direct taxes is the most likely outcome.

ii) Discretionary factors

Discretionary action, particularly when it leads to the introduction of a tax instrument, is also an important factor in determining how much different sectors are called on to contribute to government's revenue requirements. Again, as was the

case with elasticity factors, it is possible to identify a number of trends or patterns which are likely to emerge in a country's tax structure during the process of economic development.

In this regard, it is the contributions of Hinrichs (1966) and Musgrave (1969), which are particularly relevant. In both of these works, the authors stress that rising expenditure requirements, coupled with the inability of the existing revenue sources to finance these increases, inevitably results in the incorporation of additional tax sources.

The exact type of instruments will of course vary according to the stage of economic development reached, with different stages characterized by the emergence of different tax bases. For example, in the case of a developing country (e.g., S. Africa) undergoing the process of import substitution and increased domestic production, the tax structure is likely to be characterized by the increased utilization of internal indirect tax sources, such as sales taxes. This 'later' period is also likely to be characterized by the increased centralization of revenue collections.

The S. African experience in this regard has not been an exception, and the increased utilization of internal indirect taxes as well as the centralization of revenue collections have both manifested in the development of the tax structure.

The increased utilization of internal indirect taxes featured clearly in the only two major additions to the tax structure - sales duty in 1971 and GST in 1978. In both of these cases,

growing expenditure requirements, coupled with the saturation of existing revenue sources, forced government to utilize some of the new tax bases which had emerged with import substitution and increased domestic production. This was especially the case in regard to GST which was introduced specifically to combat the low tax bouyancy of the tax system.

For the seven year period prior to 1978, the 'historical bouyancy' of the tax system (i.e., automatic and discretionary elements) excluding individual income tax, measured only 1,016. In other words, total tax collections (excluding individual income tax) had almost failed to rise in real terms over this seven year period, despite discretionary action. On the other hand, expenditure requirements were growing at a rate far in excess of this (Abedian and Standish, 1984). In short, existing tax bases had neither the necessary base to income nor the tax to base elasticities to automatically finance growing expenditure requirements. Consequently, with the possible exception of sustained increases in income tax rates (already at their peak), the only option left available to government lay in the incorporation of an additional tax source. As Franzsen noted at the time:

" The behaviour of the various components of our tax system during the past five years shows why it was deemed necessary to impose a new tax capable of generating sufficient revenue to meet the growing needs of the State and also to provide much needed relief to the individual taxpayer."
(Franzsen D., 1978, p.21).

The centralization of revenue collections was a further feature of the tax structure in this period. A first step in this direction came in 1957, when the Central government took over the

right of the provinces to levy and collect company income tax. A second move, which led to the almost complete centralization of revenue collections, took place in 1971, when the same innovation was applied to individual income tax. Today, 'the Provincial Authorities....retain only very limited taxing power and the bulk of their financing must be obtained from government subsidies' (Browne, 1974:11). Moreover, unlike local authorities which are at liberty to adjust their own rates (albeit on a limited number of taxes), the provincial authorities are from a fiscal point of view not unlike general government departments.

Whilst neither of these changes had significant effects on the revenue mix, both moves have had implications for redistribution. This is especially so in the light of the subjective concept of 'needs' versus 'ability' (see p.103) implicit in the subsidy formula accepted in 1971. This subsidy arrangement provides the legislative mechanisms for considerable redistribution from 'richer' to 'poorer' provinces, the gold rich provinces undoubtedly being among the former. The extent to which this redistributive conduit has been used, however, is an empirical issue beyond the scope of this thesis.

As stated above, aside from changes in revenue composition directly attributable to the incorporation of new taxes, some degree of variation is also attributable to changes in rates. In most cases though, these adjustments have not had a major impact (excluding possibly GST rate adjustments), and are in any event decided in the political sphere and are thus not a feature of economic development per se. Consequently they are not discussed separately here but are referred to again in Chapters 4 and 5.

To sum up: economic development has influenced the composition of revenue collections in two main ways: a) directly through its effect on base to income elasticities, and b) indirectly through the incorporation of additional tax sources. Moreover, with few exceptions (e.g., the behaviour of mining revenue), these changes themselves are roughly consistent with changes observed in international studies and with predictions implicit in the economic development approach.

3.5 Tax Policy and Economic Development

The second major tenet of the economic development approach, focusses on the extent to which economic development factors restrict the number and types of options available to tax policy planners. Here, both Hinrichs and Musgrave, broadly distinguish between two major phases, each of which is characterized by varying degrees of freedom and flexibility in tax policy.

To recap briefly: the 'early' or pre-fourth/fifth stage was identified as one having a shortage of feasible tax bases, a high reliance on traditional and indirect tax sources, a relatively low tax ratio, and a high degree of tax 'effort'. In contrast, the fourth/fifth or 'later' stage, sees greater sophistication and versatility in policy, a higher tax ratio, the absence of 'traditional' sources of revenue financing and a relatively lower degree of tax 'effort'. This is chiefly ascribed to the emergence of a wider range of feasible tax bases and 'handles'.

An analysis of S. African data using these criteria clearly

reveals these two phases, each of which is further divisible into two sub-periods.

The first sub-period comprises the immediate post-war period 1946 to 1950. Rising post-war expenditure requirements, coupled with strong pressure on government to reduce the high rates of tax imposed during the war, made this one of the most difficult periods for tax policy planners. The task was further exacerbated by the shortage of feasible tax bases and by the lack of depth in the existing tax sources.

The base for individual income tax, in particular, although providing some 25% of total revenue collections, was characterized by a chronic shortage of the crucial middle and high income earners. For example, in 1947, of the almost 250 000 registered taxpayers, only 40 000 or 16% earned sufficient income (i.e., > R600) for tax to be levied (see *The Argus*, July 30, 1949). And, although the severity of this problem was primarily a post-war phenomenon, an even smaller percentage of those eligible financed the vast bulk of the tax bill.

Over this same period, the contributions from the remaining major sources of revenue, mainly company and customs and excise, fell. This was despite the post-war boom conditions created by the removal of a wide range of restrictions. As a result there was a fairly heavy reliance (21%) on the so-called 'traditional' taxes normally associated with tax structures in less developed countries. Together, these factors culminated in a low tax ratio (13%), as well as an inordinarily high share (40%) of indirect tax in total revenue collections (Table 2.4).

Massive post-war expenditure requirements also eliminated any chance of reducing tax rates to pre-war levels. As proponents of the 'Displacement Effect' might have predicted, the Minister of Finance, in his first major post-war statement on tax policy declared:

" The high tax rates on income, on companies, on mines, on excisable commodities have generally come to stay. They reflect the higher burdens on the community for war debt, pensions and rehabilitation, and for the social services on the higher scale now in force."

(Hansard, 1948, Vol. 64, col.40).

A second period lasting nearly twenty years began in the early 'fifties following devaluation (1949), a rise in the price of gold, a commodity boom, and the discovery of new gold fields in the Western Transvaal and the Orange Free State. Corresponding to Browne's (1983:148) 'years of consolidation', tax policy in this period differed from that in earlier years due to the emergence of a number of new tax bases as well as considerable broadening in the existing ones, in particular mining. A useful spin-off of mining sector growth was in increased secondary sector activity. This resulted in substantial increases in the tax contributions from general companies. Comprising only 10% in the late 'forties, these contributions leapt to almost 25% by the end of 1956, with the rise in the company tax rate from 20% to 25% having only a limited impact.

The most notable effect of the increased flexibility afforded by growth in this second period was in the substantial tax cuts introduced in 1954. This move was further facilitated by the

rapid expansion of the base for income tax. By 1954, the number of registered taxpayers had swelled 3.6 times the 1947 level to 900 000, and the number actually eligible for some payment 17 times to 690 000 (see The Argus, Aug 3, 1954). On the other hand, over the same period, reliance on traditional tax sources began to diminish significantly.

The options available and hence the flexibility in tax policy expanded during the 'boom' period which lasted until 1965. The introduction of PAYE in 1960, the effects of the centralization of company tax (1957), as well as the the introduction of the provisional tax payment system for companies (1963) and certain self-employed individuals were among the major contributors to this. One consequence was the tax 'discounts' granted to individuals and companies in the early 'sixties.

This period of economic development, although enabling greater flexibility in tax policy, did not generate any meaningful growth in revenues. Figure 3.2 shows that despite contributions from general companies mining companies and income tax, the overall tax ratio, by 1965, had still not risen much above its post-war levels of 12 to 13 per cent.

The lack of alternative sources available to government also effectively eliminated the possibility of using the tax system as a tool of economic policy. During periods of recession, for example, substantial tax cuts in any of the major tax sources were seldom considered to be a policy option given the lack of alternative means of financing. This was further exacerbated by the distinct reluctance on the part of the authorities to incur

large budget deficits (see Van der S. Heyns, 1982:53-4).

The extent to which these factors restricted the tax authorities was noted on a number of occasions. For example, in the 1965 budget speech the Minister of Finance remarked:

" In South Africa we do not have at our disposal, the full range of fiscal instruments available in some countries to regulate the course of the economy. We do not for example have a general sales tax quite common today in many countries."
(Hansard, 1965, Vol.14, col.3314).

A third period (and second phase) began in 1971 following the Franzsen Commission of Enquiry. Their recommendations initiated the start of a major tax reform programme beginning with sales duty and substantial individual tax cuts. It was, however, S. Africa's developing country nature which again substantially reduced the range of options open to the Commission.

The obstacles in the way of formulating an equitable individual income tax policy were especially evident. In comparisons with the distribution of the tax burden in the First World, the Commission highlighted the fact that despite economic development, only some 8% of the population paid income tax, as against 30-40% in highly developed economies (Franzsen, First Report, Para.16). The ambitious individual income tax concessions introduced for the high income earners in 1971, were thus not sustainable and were soon abolished.

In addition to these structural constraints, the public and private sectors lack of familiarity with more sophisticated broadly based tax systems, reduced the possibility of

incorporating any of a number of tax instruments commonplace overseas. A Value Added Tax (VAT), for example, was dismissed by the Commission as being too difficult for the business sector to handle. As they put it:

" Because of the great administrative demands made by the value-added tax, it can be considered for practical application only at a stage when Commerce and Industry, as well as the fiscal authorities, are capable of handling it."

(Franzsen, First Report, 1968, p.45).

As stated earlier, when the Commission finally opted for a selective sales duty, its decision was based on the grounds that it was relatively 'simple' and cost effective to operate. Similar reasons were given for the need to centralize the collection of individual income tax (completed in 1971).

Although the Franzsen Commission proposals introduced a measure of increased flexibility in tax policy, by 1974, the leeway provided by sales duty and centralization had been almost totally utilized. With maximum marginal rates set at record levels of around 78% (incl. of loan levy), it soon became apparent to the taxing authorities that a selective sales duty had neither the base nor the capacity for ensuring large scale tax collections. In short, whilst it did broaden the overall tax base marginally, its own base was too narrow to have a major impact especially after constant erosions by exemptions.

By 1976, this situation had worsened as a result of falling yields from company tax and customs and excise duties. This in turn limited the ability of the authorities to reduce their reliance on individual income tax or to use the tax system as a flexible

tool of economic policy. As one source put it:

" The decline in the relative importance of indirect taxes as a source of fiscal revenue was a matter of concern to the authorities, as only 22 per cent of the economically active population paid income tax and 30 per cent of the income tax payers contributed 80 percent of the total income tax revenue....The narrow base, the declining percentage of customs, excise and sales duties and the fluctuating and unpredictable revenues from the gold and other primary producers, together effectively limited the ability of the authorities to employ taxes as fiscal regulators."
(Nedbank Economic Review, 1983, p.189, emphasis added).

A last period began in 1978 with the introduction of GST. Largely in an attempt to reduce the reliance on direct tax, the introduction of GST was made possible by the emergence of a number of factors some of which had not been available to the taxing authorities before. The first and most important of these was the existence of a large enough base on which a broadly based consumption tax could be efficiently levied. The second was the familiarity and experience which had been gained by the public and private sector from six years of working with sales duty.

The effect of the additional revenue provided by GST on the management of other rates, and indeed on tax policy as a whole, at least up until 1985, cannot be overstated. Although partially aided by rising average income tax rates caused by fiscal drag and by mining surpluses in the 1979/80 gold boom, the revenues from GST have enabled both the maximum marginal rate, as well as the level at which it becomes payable, to be lowered on a number of occasions. Today, after successive rises in its rate, GST is

the second most valuable source of revenue to government after individual income tax, accounting for some 26% of revenue needs.

An historical examination of South Africa's tax 'effort', also reveals two distinct phases in S. Africa's tax policy history. Importantly, they also correspond with the two main phases identified above.

Broadly defined, tax 'effort' refers to the success level of government discretionary action in raising (or lowering) tax collections above (below) the level that would have been collected in the absence of such change. It follows, therefore, that where government is faced with rising expenditure requirements and a lack of feasible tax bases, the existing revenue sources may have to be extensively used. In other words, government may have to introduce a considerable number of discretionary changes (e.g., raising tax rates) in order to raise the required finance. This would in turn be reflected in a high degree of tax 'effort'. Conversely, if the yields from the available tax sources 'automatically' provide sufficient revenues for government, effectively eliminating the need for tax hikes, or indeed enabling tax cuts, than this would manifest in a lower degree of tax 'effort'.

Table 3.3 below presents S. Africa's tax effort in five yearly periods for the period 1945 to 1985. Also included are the corresponding elasticity and bouyancy estimates from which the index was constructed. (The actual method of calculation is discussed in footnote 7).

PERIOD	BOUYANCY (1)	ELASTICITY (2)	'EFFORT' (3) <small>(1-2)/2 x 100</small>	AVERAGE TAX RATIO
1946-50	0.62	0.79	-21.0	12.1
1951-55	0.93	0.84	10.7	12.9
1956-60	1.04	0.92	13.0	12.4
1961-65	1.51	1.10	37.2	13.1
1966-70	1.66	1.15	44.3	16.4
1971-75	1.11	1.09	1.8	20.5
1976-80	1.15	1.10	4.5	21.9
1981-85	1.16	1.13	2.6	23.8

TABLE 3.3 TAX BOUYANCY, ELASTICITY AND 'EFFORT', 1946 - 1985.

Turning to Column 3 (tax effort), two major phases are clearly visible, each characterized by varying degrees of tax effort.

The first period, 1946 to 1970, corresponding with the pre-Franzsen Commission period, displays a consistently upward trend in government's attempts to finance its expenditure requirements out of the existing revenue sources. This was particularly evident between 1961 and 1970 when tax effort was at a maximum, despite a high elasticity averaging 1.15. The combined effect of both of these factors raised the tax ratio from 12,4% to 18,7% in only a decade. Interesting too is that the latter half of this period (1966 to 1970) coincides with what Browne (1983:154) terms the 'years of fiscal expansion'.

By contrast, the post-1970 phase has been characterized by a

relatively lower degree of tax effort. This can be ascribed to a) the relatively higher 'natural' elasticity exhibited by the tax system over this period, itself a consequence of new tax additions (sales duty and GST) and increased mining revenues, and b) increased contributions from individual income tax as a result of fiscal drag. Tax collections over this period thus grew faster than GDP with the result that tax authorities were able to avoid tax increases and indeed were able, on occasion, to cut taxes. This resulted in a reduced tax effort.⁸

It is also interesting to note that throughout the whole period, the tax bouyancy of the system has exceeded its tax elasticity. In other words, despite tax cuts, discretionary action over almost the entire period has generally had a positive effect on the size of revenue collections. The sole exception is the period 1946 to 1950, during which a series of post-war tax cuts were instituted. Noticeable too is that the natural elasticity of the tax system has increased markedly from since the immediate post-war figure of 0,79 to 1.13 in the last five year period. This increase may be partially ascribed to the increased utilization of income elastic taxes, a general maturing of the tax system, as well as to the effects of fiscal drag on personal income tax collections, especially between 1973 and 1985.

To sum up: specifically in these terms, the evolution of S. African tax policy can be divided up into two broad phases. A first phase comprised the period 1946 to 1970. During this period, tax policy remained heavily restricted by S. Africa's developing country nature. Few tax policy options were available, the existing tax sources were thin and tax 'effort'

was thus relatively high.

A second phase began in the early 'seventies. Partly due to the gold boom and corresponding rise in mining revenues, and partly as a result of the emergence of a base for sales duty and GST, the constraints on tax policy were significantly loosened. This in turn resulted in increased flexibility and sophistication in tax policy and overall a lower degree of tax effort.

It is important to note, however, that S. Africa's trend toward increased utilization and reliance on internal indirect taxes and income tax, although consistent with what Hinrichs' General Theory (1966) regards as a natural progression from the third to the fourth and fifth stage of tax structure development, does not mean that S. African tax policy has finally broken free of the constraints associated with tax policy in developing countries. There are at least two reasons for this:-

Firstly, on an economic level, S. Africa's skew distribution of income, although not as pronounced as it has been in the past, still serves to limit to a minimum the range of tax policy options available to the taxing authority. Tax reform initiatives (e.g., a flat income tax rate) presently being introduced in more developed countries cannot, therefore, be considered at this stage of S. Africa's economic development. This in turn is complicated by S. Africa's relatively low level of business sophistication which eliminates the possibility of successful implementation of more comprehensive trade taxes such as VAT.

Secondly, political factors unique to S. Africa further restrict

the utilization of indirect taxes to the same extent to which they are used overseas. This is due to the fact that the burden of these taxes falls most heavily on the Black working class, the taxing of whom is quickly becoming a controversial and volatile issue (see Chapter 4). GST in its present form can thus be said to have been almost fully utilised. Similarly, political factors exclude the use of other taxes such as capital gains tax, wealth taxes, and property tax, the probable victims of which are presently among the more influential of special interest groups.

Falkena, in his evaluation of the prospects for S. African tax policy in the future, stresses some of these points. In his own words:

".....in contrast with the developed industrial nations, South Africa is for political reasons not in a position to make as free use of the instrument of indirect taxation as income tax, while the unequal income distribution and divergent social conditions place constraints on tax policy." (Falkena, H., 1980, pp.100-101).

3.6 Economic Development and the Costs of Collection

The last aspect of the economic development approach discussed centred on the important rôle that the costs of collection play in the determination of tax policy and hence tax structures. Musgrave (1969), Hinrichs (1966) and especially Alt (1984), contend that during the course of economic development, taxing authorities continually attempt to minimize tax collection costs (at the margin), either internally through administrative innovations, or indirectly through 'farming out' the tax collection process to the private sector.

S. Africa's experience in this regard has not been an exception, and a number of major tax initiatives are consistent with this reasoning.

Perhaps S. Africa's first major tax innovation intended specifically to reduce collection costs, took place in 1952 with the scrapping of the private company apportionment system. Although very attractive from an equity point of view, the actual cost of collecting taxes from individuals under this system, as opposed to companies, was considered to be a major drawback. As the Minister of Finance remarked:

" Another very serious disadvantage of the apportionment system, is that instead of collecting the tax on the basis of a simple formula at the source from the company the tax liability of each shareholder must be determined before tax can be collected. Consequently this system multiplies the work of the Inland Revenue Department and militates against the speedy collection of taxes"
(Hansard, 1952, Vol.78, c.3429, my emphasis).

With the abolition of this system, the actual costs involved, as well as the extra administrative work associated with this scheme were effectively eliminated. Today, possibly at the expense of equity considerations, the taxation of companies is a relatively simple and cost effective process, with private company tax paid and collected at the source.

A second move in this direction took place in 1962 with the introduction of PAYE. Although widely publicized as an aid and advantage to individual taxpayers, little was made of the fact

that the PAYE system was, in essence, a move aimed at 'farming out' collection costs to the private sector. PAYE converts public sector administrative costs into private sector compliance costs, by designating employers legally responsible for the monthly calculation, deduction and submission of personal income tax.

From a tax collection point of view, therefore, private sector firms now act as involuntary and unpaid tax collection agents with the associated costs, termed compliance costs, borne almost entirely by them. And, although no local input is available, international studies show that compliance costs may constitute a large percentage of a firm's total administration costs (see Slemrod, 1986). As one local source notes:

"There can be no doubt that a PAYE system imposes a burden on the employer. He will be made responsible for the deduction of the tax from his employees' salaries and for remitting the tax deduction to the Revenue office.....The system may also involve additional clerical staff....."
(The Taxpayer, 1955, March, p.42, my emphasis).

In addition to cost reductions in collection, the introduction of PAYE has since 1962 resulted in considerable revenue gains for the Treasury. Firstly, with employees' tax liabilities being automatically withheld at the source, successful tax evasion has been considerably minimized. Secondly, with the job of tax collection in the hands of the private sector, the whole process of taxation has undoubtedly become more sophisticated and efficient, as firms try to minimize the costs involved. Indeed, so effective was the PAYE system in this respect, that the once-off 30% increase in the total tax yield over the period 1962 to 1963, can be ascribed almost solely to this change in the method of collection (Krogh, 1969:297).

Cost of collections were again a major factor in the Franzsen Commission's decision to recommend the introduction of a selective sales duty in preference to other options. Echoing the sentiments expressed by the Canadian Revenue Dept., the Franzsen Commission stated that the 'low cost of collection is indeed the main attraction of this particular form of taxation' (Franzsen First Report:42 emphasis added).

Similar arguments can of course be forwarded in regard to GST. In addition to the cost of initial modifications (e.g., electronic tills etc.), the costs associated with the calculation, collection, and forwarding of GST to the tax authorities are borne almost entirely by the private sector. Furthermore, penalties for late payments contribute to its efficacy.

More recently, this process has undergone further rationalization with the latest regulations effectively halving the number of vendors rendering GST by eliminating smaller firms from the system (see Cape Times, Aug 1, 1986). The latter are now required to pay the GST tax to their suppliers (e.g., wholesalers) obviating the need to collect it from them. This is especially useful in the collection of GST from businesses in certain Black townships, from which tax collection has been severely hampered during the 1985/86 disturbances.

Although other factors played a role (see Chapter 5), the innovations and developments which took place in Black taxation between 1978 and 1984, and the reason for the introduction of the

final PAYE deduction scheme, are also best interpreted within a cost of collection framework.

As discussed earlier, Black taxpayers, at least up until 1984, were subject to a separate tax system. This was complete with its own administration, organisation, legislation and enforcement. All in all, this 'apartheid' in taxation entailed additional costs for the taxing department. Indeed, prior to the passing of the 1969 Black Tax Act, the Department of Inland Revenue itself, on these very grounds, objected to the continued use of a system based on separate taxation (see McGlashan, 1984:130).

By 1980 it had been finally accepted that South Africa could not afford a separate tax system for Black taxpayers on both economic and political grounds. Steps were taken to remove discrimination from the tax system, the process being completed in 1984.

Although not yet evident in tax collection statistics, the effect of these changes will obviously have important implications for the costs of collecting taxes from the Black population, for at least two reasons. The first is purely administrative i.e., with the scrapping of the 1969 Act, the costs associated with the enforcing a separate Act were effectively eliminated. Secondly, and most importantly, the effect of deracialization in taxation has resulted in the incorporation of Blacks into the well-established PAYE system of deduction, the upshot being that the job of collecting individual income tax from the vast bulk of the Black population is now a private sector concern. In a sense,

the deracialization of taxation has done for the costs of collecting tax from the Black man, what the PAYE system did for collection costs in 1962. What is more, this 'farming out' process has also pushed the private sector into the role of enforcer of law, relieving government of considerable political pressure. To quote one source:

"Increasingly, private business is drawn into law enforcement. When.....a new tax structure was introduced to equalise Black taxation principles with the existing White terms, the government, much to the chagrin of management, left it to the employers to explain the higher taxes to their Black work force."

(Adam, H., and Moodley, K., 1986, p.139).

Cost of collection factors were again the major reason for introducing a final PAYE deduction scheme following the inclusion of Blacks into the system. Had the PAYE final deduction scheme not been introduced, the tax department may have been flooded by an extra 4-5 million tax assessments with the scrapping of the 1969 Act (see McGlashan, 1984:133). Clearly, the associated costs would not be justified given the low net returns associated with Black taxation (for statistics see, Hansard, 'Q&R' April, 1986, c.1244). The introduction of the final deduction scheme was, therefore, a very efficient means by which this vast increase in administration costs could be avoided.

Today the task and cost of collecting income tax from almost the entire White and Black working class effectively lies in the hands of the private sector. The final PAYE deduction scheme further ensures that the cost of processing low-income tax returns are kept to a minimum.⁹

Besides influencing major tax initiatives, cost of collection arguments have also had a role to play in a number of minor tax policy innovations. Included here would be; the abolition of the separate tax tables for Super and Normal tax, which imposed a 'heavy burden' on the Revenue Department, and the centralization of revenue collections in '57 and '71.

It should of course be mentioned that the enormous costs incurred in the private sector as a result of this 'farming out' process seriously call into question the usefulness of the 'cost of collections' statistics issued by the Inland Revenue Department yearly. Since these costs do not include the compliance costs borne by the private sector, they seriously understate the total costs involved in tax collection.

3.7 Conclusions

The evolution of the South African tax structure over the past forty years clearly reflects changes in the underlying structure of the economy itself. What is more, much of this change is consistent with aspects of the economic development approach.

Growth in the size of the tax ratio, in particular, has been a feature of this development. Over the forty year period under review, this ratio has grown markedly and pari-passu with growth in the country's taxable capacity. To some extent, growth in the latter is itself explained by variations in per capita income, the sectoral composition of GDP, and to a lesser extent the 'degree of openness' of the economy.

The change in the composition of these collections is another feature of the tax structure strongly influenced by economic development. In this regard two factors have played a role. Firstly, on a direct level, economic development has had an unequal influence on the various base to income elasticities of the major tax sources and, therefore, on their relative revenue contributions. Secondly, on an indirect level, economic development has produced a number of additional tax bases, the incorporation of which (mostly prompted by rising expenditure requirements), has resulted in a drastic change in the revenue mix.

Tax policy has also clearly been influenced by the country's stage of economic development. The application of various tax development criteria to the history of SA tax policy reveals two distinct phases (pre and post 1970), each of which is characterized by varying degrees of flexibility in tax policy. Economic development has not, however, taken South Africa to the stage where it can be said that tax policy is free of constraints generally associated with tax policy in developing countries.

Lastly, cost of collection factors have also influenced a significant number of tax initiatives. Careful reading of the history of tax policy reveals that a number of major tax innovations have been implicitly designed with the aim of 'farming out' the tax collection process to the private sector. One consequence of this is that the private sector has become increasingly drawn into the tax collection process.

PART THREE: INTERPRETATION (CONT.)

CHAPTER FOUR: EVALUATING THE PUBLIC CHOICE APPROACH

4.1 Introduction

The public choice approach to tax structure change highlights the role that political factors play in the determination of tax policy. To recap briefly: in the 'classic' Downsian scenario, the evolution of tax structures is viewed as a direct result of tax policy instituted by a democratically elected government acting in accordance with the preferences of the majority of the electorate. Politicians own preferences play a minimal role and the tax system is entirely median voter determined. Later extensions to this one-way causality argument, however, maintain that in reality, tax policy reflects the interests of both voters and politicians. In these later models, factors including; 'full-line' supply, electoral tax cycles, fiscal illusion and special interest groups, emerge as powerful determinants of policy outcomes.

This chapter evaluates this approach, following closely the methodology adopted in the previous chapter. That is, it attempts to show the extent to which the public choice approach accounts for the evolution of S. African tax policy in the post-war period.

The outline of this chapter is as follows. The first section identifies some of the major difficulties associated with developing a public choice perspective for S. Africa. Thereafter, the remaining three sections focus on factors affecting; the

distribution of the income tax burden, the timing of tax announcements, and the choice and utilization of alternate tax instruments.

4.2 Taxpayers, Voters and Elections (1946 - 1983)

Any attempt to develop a public choice perspective on taxation should begin by first clearly establishing the extent to which tax issues have influenced voting decisions and political party behaviour. In addition to putting the whole analysis into an appropriate perspective, an understanding of the role that taxation has played in the determination of voting decisions enables a researcher to identify which public choice hypotheses (if any!) can realistically be expected to provide answers to the evolution of S. African tax policy.

Unfortunately, with the possible exception of contributions by Lever (1972, 1978) and Heard (1974), very little is known about this aspect of voting behaviour in S. Africa. Election studies by Schlemmer (1973), Peele (1976), Lemon (1982), Charney (1982), and others¹ although providing some valuable insights into election strategies, intra-party dynamics, voting demographics and historical trends, have virtually nothing to say about the effects that taxation has had on voting behaviour. Nor do they give any attention to whether party allegiance has been affected by changes in individual tax burdens, or in the state of the economy. Rather, they maintain that voting behaviour, party support and election results throughout the post-war period, have centred almost exclusively around the question of the race policy regarding Blacks i.e., that tax issues have played (at

best) a negligible role in forming voting opinion, having never emerged as an election issue or been part of any political party manifesto.²

These same conclusions are clearly implicit in Heard's investigation into elections and election issues for the period 1943 to 1970. Couching the argument in terms of a broad discussion of so-called 'economic issues',³ Heard maintains that although changes in 'economic conditions' (salaries, taxes, COL etc.) did at times prompt some voters to switch party allegiance (or to abstain), the numbers involved in all cases were small. This Heard attributed to strong traditional Afrikaner loyalty to the Nationalist Party (NP), an emphasis on the issue of race policy, and most importantly general economic prosperity. In his own words:

"While economic issues were raised during this period,.....(1943-1966).....on the wholeSouth Africa's persistantly booming economy reduced their salience and one cannot say that they had any profound effect on political decisions, except in so far as satisfaction with the government's performance persuaded some voters to vote for it or restrained some from voting against it. There is little to suggest from the study of the elections concerned that such hypothetical voters formed a significant percentage of the whole."

(Heard, H., 1974, pp.238-239, emphasis added).

Lever's (1972) more detailed survey and questionnaire study of the post-'boom' 1966 election came to a similar conclusion. This is clearly evident in many of the surveys conducted for the election. For example, in one pre-election poll, voters were asked to identify what they considered to be the 'major issues' confronting the economy at the time. Of a total of 707 separate 'issues' identified by 580 respondents, the 'economic problem' (i.e., salaries, taxes etc.) was mentioned only 8,1% of the time

(p:58). On the other hand, as expected, the issue of race relations was dominant comprising some 60,8% of all replies.

Heard maintains that even after 1970 (i.e., during the period corresponding with the beginning of a major downturn in the economy), increased inflation, higher tax bills, and 'a general decline in the administration's image of efficiency and general good husbandry', still did not result in large numbers of voters either switching traditional party allegiance or abstaining.

These same observations were also made in Lever's study of the major issues surrounding the 1970 election. Here Lever found that whilst some working-class areas highlighted tax and related issues more frequently than previously, the proportion of these voters in the total electorate was small, so that '....these grievances did not provide a large a large number of party changes....(although)...it did provide some' (Lever, 1972:175).

Additional support for this view is also clearly evident in numerous pre-election polls drawn from the working-class constituencies of Johannesburg/West and Jeppe. For example, in one survey, voters were asked to identify what they considered to be the most 'important issues' facing S. Africa at the time. Out of a whole range of issues offered, the 'economic problem' was first mentioned only 5,6% of the time, only slightly up on the 4,7% registered in the same survey undertaken in the 1966 election (Lever, 1972:191). Again, as expected, the race issue dominated the majority of responses.

It is also crucially important to note (the reasons for which are

discussed later) that at least up until 1966, and possibly by as late as 1976, a large portion of the electorate paid either little or no personal income tax at all (see Table 4.1). As a result, the issue of taxation, at least in terms of the all important personal income tax, was basically absent from the minds of many voters.

The extent of this phenomenon was evidenced in the 1950 budget speech. Here, it was reported that at the time there were only 323 000 White income taxpayers in the entire country. At the same time, however, election statistics indicate that there were almost 1,35 million registered voters (Heard, 1974:58). If one makes a realistic assumption that most taxpayers were registered voters, this left at least 704 000 voters or massive 52% of the electorate who did not pay any personal income tax at all!⁴

Despite rapid economic development and significant rate adjustments, the same disparity characterized taxpayer statistics in the 'sixties. In 1965, for example, out of a total of 1.9m White individuals assessed for income tax, 0,67m or 35% of taxpayers did not earn sufficient income to pay income tax. This meant that of the 1.6m registered voters in that year, as many as 41% did not pay any income tax. In addition, based on 1965 tax tables, out of the remaining 1.2m individuals who did qualify for tax, a further 90% of these were liable for tax in the R4600 range, for which the average tax rate was at most 8%.

Admittedly, by 1976, the disparity between voter and taxpayer numbers had all but disappeared. Nevertheless, in that year, the bottom 60% of taxpayers still paid on average only R104 per head,

corresponding with an average rate of only 7% (Hansard, 'Q&R', 1977, April, c.950).

To sum up therefore: strong traditional NP party allegiance, a stress on the question of race policy, and a skew distribution of the tax burden, meant that for large portions of the electorate tax was simply not an issue, and, therefore, not an argument in the determination of political party support.

The central conclusion that flows directly from this statement is clear: a Downsian-type scenario i.e., one in which the government is under constant and continual pressure from the electorate to provide a tax policy consistent with that electorate's preferences to ensure re-election, has very little real world applicability for South Africa. Attempts to interpret tax policy evolution along these lines cannot, therefore, be considered realistic, since individual tax awareness is a crucial and active variable in the Downsian model. Furthermore, for similar reasons, little insight would be gained from examining aspects of the Pommerehne/Schneider hypothesis which parallels the Downsian scenario in the immediate pre-election phase.

It is also clear from the above that the 'weight' attached to broader political issues has given government and tax authorities considerable scope, if not a 'free hand', in their formulation of tax and other unelectorally contentious policies. A realistic approach to the interpretation of tax policy evolution must, therefore, focus on models which assign significant 'autonomy' to decision makers, de-emphasizing the role of direct voter participation in tax policy determination. Included here, for

example, would be Hettich and Winer's (1984) approach which sees the median voter playing a less crucial role and where tax policy is developed 'endogenously' by politicians in response to changes in political constraints.

It is equally important to note that given the nature of the S. African scene, tax policy outcomes must also be viewed within the context of Breton's (1974) notion of 'full-line supply'. That is, tax policy should be seen as simply one policy out of a whole range of policies which together comprise the total policy 'package', and, therefore, not the issue around which voting decisions have been made, if in fact it has been an issue at all.

4.3 The Distribution of the Individual Income Tax Burden

Possibly the most powerful manifestation of the government's ability to tax, is the individual income tax (hereafter referred to as income tax). Although only one of a number of taxes levied by Central government, its distinguishing feature is its relatively high visibility, a result of it being paid directly out of gross income earned at monthly intervals, re-inforced by annual assessments. It is thus often the core of the individual's perception (estimate) of his total tax burden, and the tax to which level and changes taxpayers are most sensitive.

On the question of the management of the distribution of this burden, the public choice approach is clear: government will as far as possible (i.e., within given economic constraints), schedule income tax rates so as to minimize the expected political costs associated with raising a given amount of

revenue. In what essentially amounts to a policy of vote-maximization, this hypothesis holds that income tax policy will be broadly designed to ensure that voters who are crucial to re-election (i.e., those forming the bulk of the party's potential voting base) will be subject to tax burdens relatively lower than other less politically valuable sections of the electorate.

This section investigates the validity of this hypothesis, the data for which is presented in Table 4.1 below:

TAX YEAR	SHARE OF THE INCOME TAX BILL PAID BY TOP 10% OF TAXPAYERS	MAX-IMUM MARG RATE ⁵	SHARE OF THE INCOME TAX BILL PAID BY THE BOTTOM 50% TAXPAYERS	BOT-TOM RATE	SOURCE
1960	63%	50.0%	14.1%	6%	INLAND REVENUE ANNUAL REPORTS 1961/62.
1964	65%	47.5%	8.1%	6%	INLAND REVENUE ANNUAL REPORTS 1965/66.
1966	62%	52.5%	9.1%	6%	INLAND REVENUE ANNUAL REPORTS 1967/68.
1969	Top 6% paid 67%*	66.0%	n/a	5%	FRANZEN R.P.24/1969 para 16.
1974	54%	63.0%	8.3%	9%	HANSARD 'Q&R', 1976 Col.663.
1976	52%	72.0%	7.9%	9%	HANSARD 'Q&R', 1978 Col.581-2.
1978	50%	66.0%	7.6%	9%	HANSARD 'Q&R', 1980 Col.199-200.
1980	57%	50.0%	4.3%	8%	HANSARD 'Q&R', 1983 Col.180.
1983	49%	52.5%	6.2%	10%	HANSARD 'Q&R', 1985 Col.231-4.

TABLE 4.1 THE DISTRIBUTION OF THE INDIVIDUAL INCOME TAX BURDEN, 1960-83

From the data, two major features are clearly identifiable, both of which have been characteristic of the tax structure throughout the post-war period. Firstly, despite a definite declining tendency, the vast bulk of the income tax bill has been financed by relatively few (10%) taxpayers at high average rates of tax. Secondly, the majority of taxpayers (i.e. ~50%) have paid either little tax (at relatively low rates) or no income tax at all.⁶

For example, in 1976, 10% of the total taxpaying population was responsible for 52% of the income tax bill, whilst at the same time, the bottom 50% of taxpayers contributed, in total, only 7.9% at average rates of 31% and 9% respectively (including the loan levy). In 1983, the corresponding tax contributions were 49% and 6.2% respectively.

Although the data are not strictly comparable, the general consensus suggests that the distribution of the tax burden prior to 1960, like the distribution of taxable income itself, was even more severely pronounced. This was due in part to the fact that pre-1960 tax rates distinguished sharply between Normal and highly progressive Super taxpayers. For example, in 1947, only 16% of registered taxpayers earned sufficient income to be taxed (see *The Argus*, July 30, 1949). Nine years later (1956) 73% of the total tax bill was still being paid by 9.1% of the White taxpaying population (Hansard, 1957, Vol. 83, col.2545).

South Africa's skew income tax burden distribution can basically be ascribed to two major factors. The first is the underlying skewed distribution of taxable income, itself a feature of the

country's stage of economic development, whilst the second is the schedule of tax rates applied. As Krogh notes:

" The comparatively small share contribution from direct taxation on individuals can principally be ascribed to two outstanding features that are both closely related to South Africa's relatively low average income per head. The first is the relatively small number of direct taxpayers in its total population.....(whilst).....the other is the traditionally low average income tax rates applicable to by far the majority of the small number of income taxpayers."
(Krogh, D., 1969, p.301, emphasis added).

Commenting on the particularly unequal distribution of the tax burden as revealed in statistics released by the Franzsen Commission, Browne highlights a similar point:

" While these figures...(i.e., those released by Franzsen)...were certainly influenced by the particular distribution of income in SA, they undoubtedly reflected an unusual concentration of tax liability and very high marginal tax rates."
(Browne, G.W.G., 1974, p.16, emphasis added).

What neither Krogh nor Browne give any attention to, however, is the role that political factors have played in the actual determination of these rates. That is, whilst expenditure requirements, equity considerations and notions of 'ability to pay' have certainly played a role, the schedule of tax rates, as manifested in the distribution of the tax burden, clearly reflects government's vote-maximizing endeavours. In short, tax policy has been designed around minimizing the political costs associated with raising a given sum of revenue, by maintaining a rate structure in which the relatively few high-income minority and numerous low-income majority have paid relatively high and low rates of tax respectively. This is compatible with both the skewed distribution of the tax burden and the low tax awareness

prevalent amongst the majority of voters/taxpayers identified earlier.⁷

Commenting on the factors affecting the distribution of the tax burden, Divaris stresses exactly this point. In his own words:

" Probably also drawn on political grounds initially is the line between those who pay a little and those who pay a lot of tax, the idea being that the....(white)..masses, whose votes are critical, should not find taxes too irksome a burden.....(Government).....can afford to ignore the cries of pain emanating from the 'rich' while.....(they)attend to the gentlest whimper of the 'poor'. In other words, 'ability to pay' is a form of numbers game and is of essence discriminatory."
(Divaris, C., 1977b, p.220).

By way of illustration, Divaris further calculated that for the tax year 1975, 86% of White taxpayers paid an average tax bill of only R339 each 'which they probably felt was a tolerable burden', whilst the remaining 14% of taxpayers paid an average of R3 459 each. In other words, Divaris found that despite rate adjustments, the average high-income earner paid over 10 times more in direct income tax as did the average low-income earner; a feature still characterizing the data today.

Support for Divaris' argument is also evident in statistics released by the Franzsen Commission (1969) some six years earlier. Comparing local tax rates with world wide trends, the Commission reported that a unique situation had emerged in S. Africa (partly as a result of the two-tier system used up until 1960), in which incomes in excess of R15 000 attracted among the highest rates of tax in the world, whilst at the same time, incomes less than R5 000 were subject to tax rates

considered among the lowest in the world. Moreover, the Commission itself admitted that this feature of the tax burden was not 'merely a reflection of an unequal distribution of income' (Franzsen First Report, para 17).

It is also important to note that the Commission itself proposed measures which were aimed at reducing the high level of tax on the high-income earner. But, although their recommendations were initially adopted by the government in the 1971 budget, these rates were once again raised to their original levels after only two years. On the other hand, the direct income tax relief given to the low-income group (also a recommendation of the Franzsen Commission), remained very much in force, further exacerbating the skew distribution of the tax burden.

This approach to the management of the tax burden has in fact been a persistant characteristic of S. African income tax initiatives and policy recommendations. For example, in the 1964 budget, ostensibly as part of an attempt to reduce the size of the so-called tax 'bulge', the average tax rate for the lower end of the tax scale were significantly reduced with the burden passed back to incomes in excess of R12 000. This severely affected high income earners' share of the income tax bill. On the other hand (the reasons for which are discussed later), when government has required additional revenue from the low-income groups, it has invariably chosen to raise indirect tax rates (whose visibility is lower) further complicating the distribution of the personal income tax burden. In other words, when government has required additional revenues from the high income groups it has generally used direct taxes, but when requiring them from

low-income earners has invariably preferred indirect taxes.

The government's approach to the management of the income tax burden can be further understood, if this same strategy is seen against the background of traditional party support and voter preferences according to incomes.

Taking 1969 as an example (Table 4.2 below), it can be seen that although the NP received some support from the high income groups prior to the early 'seventies, the bulk of its electoral base was with low-income earners. This was especially the case throughout the period 1948 to 1966, during which time the NP relied heavily on support from these groups. Conversely, over the same period, high income voters generally supported the opposition (see Heard, 1974; Lever 1972; Schlemmer, 1973). Accentuating these results was the nationalist element which resulted from the distribution of income on a linguistic basis, Afrikaans speakers being, till recently, the dominant group among White low wage earners.

	UNDER R300	R300-499	R500+
NP	63.8%	56.6%	48.1%
UP	19.3%	23.4%	27.6%

Source: Welsh, 1975:76

TABLE 4.2 THE % OF THE TOTAL VOTE BY MONTHLY INCOME GROUP, 1969.

In Hettich and Winer's terminology, the expected political costs associated with taxing the high income groups, at least up until the middle and late 'seventies was low (since they supported the opposition), whilst that of taxing the low-income earners was high. Vote-maximizing income tax policy, in reflecting these 'costs', was, therefore, broadly designed to load the high-income

earner (predominantly English speakers) with heavy tax bills, whilst at the same time minimizing the tax on the low income earner (predominantly Afrikaans speakers). In short, the schedule of tax rates in which political costs have been minimized has been one in which the high-income earners have paid a higher rate of tax than have the politically influential and numerically larger low-income earners. As Kantor puts it:

" The personal income tax system in South Africa is one where the majority of income taxpayers (voters) pay low average rates of income tax and where a politically less influential minority pay much higher rates."
(Kantor, B., 1982, p.5).

Special interests groups are also relevant here. Farmers, in particular, have been the beneficiaries of a highly preferential tax policy as a result of their disproportionate role in the electoral numbers game. Providing the backbone of rural political support, at least until the middle 'seventies (Heard, 1974), they have, as a powerful interest group and supplier of votes, received more in the way of tax concessions than any other group of taxpayers. As one source puts it:

".....The farmers, who may write off most of their capital expenditure almost immediately, may write down the values of their livestock next to nothing very quickly and, if they are still deriving a taxable income after these deductions, are subjected to tax at special average rates of tax or better."
(Tax Reporter, 1982, p.228, emphasis added).

According to Kaplan (1977:Ch 5), government first began to institute policies aimed specifically at assisting the development of agriculture and farmers, soon after the Pact victory in 1924. The strength of so-called 'Afrikaner capital' was further consolidated under 'Fusion' government, during which time a wide

range of beneficial policies were instituted. Chief among these was a wide range of tax concessions on capital expenditure, not available to any other similar class of taxpayer.

The direct effect of these concessions on the tax bills of the average farmer were significant. According to Frankel (1938), for the period 1930 to 1934, the taxable incomes of all farmers were actually less than the cost of the measures (e.g., subsidies) incurred by the government for agriculture. In 1933/34, for example, farm incomes subject to tax were only 1.6% of the total taxed incomes of the Union (see Horwitz, 1967:155).

With the NP victory in 1948, the influence of the farming community on decision making was further entrenched as a result of greater direct participation by farmers in the legislature. Indeed, in that same year, almost half of Nationalist MP's were either farmers, or connected with agriculture (Lipton, 1985:282).

In later years, the continued reliance on the farming community for votes, coupled with years of rural biased delimitation (jerry-mandering) effectively meant that rural voters attained such a great influence that 'no government could survive without the support of at least a substantial proportion of them' (Welsh, 1975:77). This dependancy was in turn reflected in a wide range of preferential policies aimed directly at the farming community in order to ensure (maximize) political support. These policies included not only tax concessions, but also price supports, low-interest loans, subsidies and so-on, all of which comprised the total policy 'package'.

The effect of the preferential tax policy which characterised the post-war budgets soon became evident in taxpayer statistics. For example, in 1953, The Commissioner for Inland Revenue reported that out of 114 000 farmers registered as taxpayers, only 8000 (7%) were liable for income tax (on their farming operations), paying on average only R200 per head (The Argus, 11 August, 1953).

Since 1962, however, statistics on farmers' taxation have not been available since the Income Tax Act of that year does not use the term 'farmer' at all. Instead, the Act only provides a list of allowances and deductions applicable to so-called 'farming operations'. Consequently, it has not been possible to determine the amount of tax paid by farmers as details concerning the actual source from which taxpayers derive their incomes are not recorded when these payments of tax are received. Parliamentary requests as to the specifics of farmers taxation have also, therefore, always drawn a blank (see for e.g., Hansard, 'Question and Replies', 1984, April 10, c.888). Suffice to say, 'if any calculation has ever been made of the total cost in terms of 'national taxable income' of farming tax concessions, it has been exceptionally poorly publicized' (Divaris, 1985c:13).

It should be mentioned, however, that since the late 'seventies, rising urban support for the NP, coupled with a declining dependence on rural based constituencies, has manifested itself in a significant realignment of tax policy regarding farmers. That is, although farmers still enjoy a very preferential tax policy (see e.g., Shrand, 1982; Stein, 1974, 1977), a number of recent tax changes have clearly been disadvantageous to them.

Possibly the most significant manifestation of this change in tax policy was evident in the 1977 decision to begin finally the taxation of previously untaxed agricultural co-operatives. Adam and Giliomee (1979:184) note that any such attempt to increase the taxation of the farming community prior to the 'seventies would probably not have been possible, given the likely political backlash. Increased taxation of the farming community thus underlines the falling significance of the rural sector in policy formulation.

To sum up: there is ample evidence to support the public choice view that the distribution of the income tax burden, although influenced by the country's stage of economic development and ability to pay criteria, clearly reflects government's vote-maximizing management of income tax rates. Consistent with party preference according to incomes, tax policy has ensured that the politically and numerically less influential high-income earner have paid, and continue to pay, the vast bulk of the tax bill, with the majority of the electorate paying considerably less. Included in the latter group is the farming community which, until recently, has received an even more preferential tax policy reflecting their role as a powerful interest group and supplier of votes.

It should be stressed, however, that the above analysis does not suggest that the NP has remained in power on the basis of the tax policy that it offers, or that a non-optimal tax policy would ever lead to its downfall. Neither is it argued that an opposition party could win an election or draw a substantial number of votes for itself by offering an alternative tax policy. Rather,

what is argued is that although voters are not directly concerned with tax issues at elections, the government's approach to the management of the tax burden has nevertheless been formulated with political cost minimization in mind. Put another way, an asymmetry exists in that whilst taxpayers/voters have not been concerned with tax issues, government, in its attempt to minimize the political costs of the tax system, has nevertheless continued to produce a tax policy roughly reflective of the preferences of the majority of the electorate.

As Hettich and Winer note, a trade-off exists between alternate tax structures and political support. What is especially unique to S. Africa is that the incentives for this trade-off are particularly weak, given the nature of the political situation and the peculiar distribution of the tax burden. Nevertheless, a trade-off does occur, government following an optimal (vote-maximizing) tax policy. It is for this reason that tax policy (at least regarding individuals) has not been as ad hoc as Kaufmann and Larkey (1980) suggest, but has followed a predictable objective function.

The government's success in regard to the management of the tax burden also carries with it three important corollaries, each of which is briefly considered below:

Firstly, the skewed distribution of the tax burden has allowed government considerable financial freedom to pursue ideological goals without having to impose the costs of these on the majority of the electorate. The financing of Apartheid, an enormous State bureaucracy, State employment, and other related policies have

not been paid for by the low-income groups (which have benefited most by these policies) but by high-income earners, the majority of whom have traditionally supported the opposition.

Although little empirical work has been completed in this area and the argument possibly a little strained, some pre-election polls even suggest that had the average NP voter been called on to contribute substantially to the financing of these ideological goals, the likelihood of their successful implementation would probably have been much less. For example, in one 1970 pre-election poll, 80% of NP supporters thought Black homelands were a good idea, but at the same time, 42% thought too much of taxpayer's money was being spent on them (Lever, 1978:148). And, in another poll, only 29% of Afrikaans speaking voters indicated a willingness to pay more in taxes in order to develop them better (Schlemmer, 1973:20). In a similar poll conducted four years later, it was found that even fewer Afrikaner (12%) were in partial or complete agreement that Whites should pay more in taxes so that Blacks could be uplifted (Schlemmer, 1980:252).

Further to this disparity in tax rates between high and low income earners has been the redistribution of income. In Chapter 5 (where this is discussed in depth), it will be shown that under all incidence assumptions, income tax, as well as the tax system as a whole, have both been (to varying degrees) progressive and largely redistributive toward low-income groups of all races. This would of course include the low-income Afrikaner who arguably has received a disproportionate share of this redistribution in the forms of farm subsidies, low-cost housing, free education and so on.

Indeed, according to a study by Sadie (1986),⁸ by as late as 1986, English speaking South Africans still paid 60% of direct income tax and 75% of company tax, despite considerable Afrikaner advance across the whole economic spectrum. Furthermore, Sadie calculated that 'most' Afrikaner families did not earn sufficient income to cover the education of their children. The tax system has thus served as a useful conduit for redistribution across both income levels and language groups.

Lastly, increased upward Afrikaner occupational mobility, coupled with a loss of support for the NP among low-income earner in the last decade, has significantly reduced the degree to which government's post-1980 vote-maximizing strategy has overlapped with a policy of maximizing traditional NP party support. Taking the average English speaking income as 100, the average Afrikaner speaker earned 55 in 1946, 83 in 1960, and 93 in 1981 (Hanf, et al, 1981:326). The near equalization of these income levels has thus meant that a tax policy pivoting around the excessive taxation of the high income groups, although still consistent with vote-maximizing objectives, is no longer wholly consistent with maximizing traditional Afrikaner support, since many of these NP supporters can now be found among these same high-income groups. Similarly, a preferential tax policy for the low-income earner has become less critical an issue since many of these taxpayer/voters have shifted their allegiance to the right wing. In one survey done in 1982, it was found that 62% of NP supporters earned over R13000 with only 38% earning below, reflecting almost a complete break with traditional low-income support and an increasing reliance on the middle and higher

income groups (Charney, 1983:143).

4.4 The Timing of Tax Announcements

A second major tenet of the public choice approach, namely Breton's (1974) electoral tax cycle, holds that politicians will time tax announcements to ensure maximum political support. According to this hypothesis, both the scheduling of tax policy announcements and also the specific nature of the tax change will reflect the length of time still to elapse until the next election. Major tax initiatives, such as the introduction or abolition of tax instruments, will be more carefully timed than would be minor adjustments to tax rates.

Thus, public choice theorists might argue that (*ceteris paribus*) the introduction of GST prior to the 1977 election, rather than after, would, at the margin, have compromised the support of portions of the electorate (even if this was manifested in voter abstention). They might also argue that the additional electoral support (however small) created by the 1980 pre-election budget concessions would not have been as great had the same benefits been introduced a year earlier.

A few examples as to the nature of the electoral tax cycle hypothesis might be useful as a means of putting the whole analysis into perspective.

In the 1965 pre-election budget, for example, the Minister of Finance, when requiring some R16m of additional revenues, expressly excluded all low and lower middle income earners from

any additional loan levies. In his own words:

" The loan levy will.....not be payable by all persons subject to income tax. I feel strongly that taxpayers in the lower and lower middle income brackets should be exempt from this levy.....this.....will exclude more than two thirds of all individual income taxpayers."
(Hansard, 1965, Vol.14, c.3326, emphasis added).

However, a year later in the first post-election budget (1967), the low income earners/taxpayers, who provided the vast bulk of support for the Nationalist Party in the 1966 elections were not considered as carefully. In direct contrast to the previous year, they were included in all additional tax hikes. As the Minister of Finance remarked at the time:

" Last year individual income tax-payers escaped any increase in tax rates except for the loan levy payable by those liable for Central Government tax of R95 or more. This excluded about 2/3 of the taxpayers. This year I think that all individual taxpayers must bear at least some of the burden."
(Hansard, 1966, vol.17, c.908, emphasis added).

Another good example is found in the 1980 pre-election budget. Here tax concessions totalling upwards of R900 million were handed out in the form of increased pensions, housing concessions, Estate duty reductions, etc. In addition, salaries of government employees were raised. A year later, however, in the immediate post-election budget, indirect taxes were raised on a variety of widely used goods including; beer, spirits, cigarettes and various imported items.

The obvious stark difference in the nature of the two budgets, although also partly influenced by a change in general economic conditions, prompted the opposition speaker on Finance to accuse

the government of deliberately scheduling tax policy changes to coincide favourably with the election period (see also; 1953 budget debate). In his own words:

"If one looks for a term to describe the budget today, one would say that it is the budget of the morning after the night before, 'the night before' being the election period. Immediately before the election period, the Minister of Finance was making concessions.....Today, however, he comes and taxes the poor man's drink, beer.....Why did.....the Minister not tell the country what he was going to do. Why were all the goodies handed out before the election and why is the day of reckoning now."
(Hansard, 1981, Aug, c.692, emphasis added).

Following Mikesell (1978), a more structured evaluation of the electoral tax cycle hypothesis is now presented. Specifically, this involves a process of allocating all major tax policy announcements into two separate 'frequency' tables in order to determine their distribution. All tax decreases and tax abolitions (of significant magnitude), and all tax increases and new tax adoptions were apportioned to Tables A & B respectively.

Both increases and decreases were apportioned to the budget period in which they were announced. Data for the period 1946 to 1983, encompassing all the general elections were used, and apportioned consistently backwards from 1983. The few innovations which occurred in t-5 were included in t-4, which of course is the same as the post-election budget. Lastly, significant mini-budget proposals were also incorporated.

For each major tax group, the number of tax changes was calculated as a percentage of total tax innovations for that group. For example, since 1946 there have been 14 company tax rate

increases or related initiatives leading to increased effective company tax rates. The columns relating to company tax show that 38% of these increases occurred in the budget immediately prior to an election (t-1), 15% two budgets prior (t-2), 15% three budgets prior and 31% four budgets prior. The latter, would also naturally correspond with the first budget after an election, and is referred to below as the 'post-election' budget.

Before presenting the results, however, two important limitations should be mentioned. Firstly, no attempt has been made to 'load' some tax changes more 'heavily' than others i.e., a 10% increase in income tax rates carries the same weight as does a 5% increase. Whilst this obviously influences the consistency of the results, the argument itself is not severely jeopardized.

Secondly, with the exception of a very brief enquiry at the end of this section, no attempt has been made to integrate the role of expenditure considerations into the analysis, despite the fact that in the final analysis they may play a critical role. Indeed, Van Waasdijk's (1964:18) analysis of government expenditure trends notes that 'election manoeuvring of this sort...(specifically increased expenditure prior to elections)... can be an important budget determinant'. At the same time, however, Van Waasdijk makes clear the difficulties associated with trying to separate the political and economic factors behind any such change. Any conclusions drawn from this analysis must, therefore, be seen in the light of these caveats.

The results of Table 4.3 can be summarized as follows:

Firstly, of the total individual income tax increases (14), 55% were announced in the immediate post-election budget (t-4), a further 27% in the budget thereafter (t-3) and only 9% in each of the budgets prior to and two years prior to all elections. Of individual income tax decrease initiatives (19), 71% occurred in the budgets two years prior (t-1 = 36%, and t-2 = 35%), and 15% and 14% in t-4 and t-3 respectively.

Secondly, of the total indirect tax hikes for sales duty and GST (9), 65% were announced in the post-election budget (t-4), 18% two budgets prior (t-2), and 17% in the pre-election budget (t-1). (GST's introduction came in 1978 after the 1977 election). As regards concessions (6), 38% were announced in (t-1), 32% in (t-2) and 30% in the post-election budget (t-4). Most of these concessions refer to sales duty concessions and only one is for GST.

Thirdly, 41% of rate increases in customs and excise duties (although mainly excise duties) came in the post-election budget (t-4), with a further 35% two years after. Only 7% of any such indirect tax increases came in a pre-election budget (t-1). As regards tax concessions for which there were far fewer (6), 33% took place in each of t-4, t-2 and t-1 (Note, all excise adjustments per budget counted as 1).

Fourthly, as regards company tax increases (14), 38% took place in the pre-election budgets (t-1), 15% each in t-2 and t-3, with 31% occurring in the post-election budget (t-4). Company tax concessions comprised 37% in t-1, 24% in t-2, 13% in t-3 and 25% in t-4.

Lastly, all 'other' taxes, including estate duty, gold mining surcharges, Transfer duty, Marketable Securities Tax, NRST tax, etc., not directly accommodated above followed a similar pattern. Of a total of 25 such increases, 33% were announced in the post-election budgets (t-4), 33% in t-3 and only 20% in any pre-election budget (t-1). 'Other' tax reductions were bunched around the pre-election periods (t-1; t-2) with 33% occurring directly before and 50% two years prior to elections.

By aggregating the increases and decreases for each of the major tax sources, the overall trend in policy announcements relative to the election period can easily be identified.

Out of a total of 81 increases and new tax adoptions, 40% occurred in the immediate post-election budget (t-4), 26% a year later (t-3) and only 19% and 14% occurred in the pre-election budgets one and two years prior to elections respectively.

PERIOD	T -4	T -3	T -2	T -1	NO. OF CHANGES
TAX GROUP					
CUSTOMS & EXCISE	41%	35	17	7	19
INDIVIDUALS	55	27	9	9	14
SALES DUTY AND G.S.T.	65	0	18	17	9
COMPANY	31	15	15	38	14
OTHER	33	33	14	20	25
TOTAL	40	26	14	19	81
i) Frequency distribution of tax increases & new tax adoptions					

PERIOD	T -4	T -3	T -2	T -1	NO. OF CHANGES
TAX GROUP					
CUSTOMS & EXCISE	33%	0	33	33	6
INDIVIDUALS	15	14	35	36	19
SALES DUTY & G.S.T.	30	0	32	38	6
COMPANY	25	13	24	37	8
OTHER	9	8	50	33	12
TOTAL	18	10	36	35	51
ii) Frequency distribution of tax decreases & tax abolitions					

PERIOD	T -4	T -3	T -2	T -1	TOTAL
"RELIEF"	7%	25	31	37	16
"TOUGH"	53	15	15	17	13
"NEUTRAL"	22	33	0	44	9
					(38)
iii) Frequency distribution by budget type					

Source: Budget Speeches: 1945-83

TABLE 4.3 THE FREQUENCY DISTRIBUTION OF TAX INCREASES, TAX ADDITIONS, TAX DECREASES, TAX ABOLITIONS (BY MAJOR TAXGROUP), AND BUDGET TYPES, IN %, 1946 - 1983.

Conversely, out of a total of 51 tax reductions and abolitions, 35% were introduced in the pre-election budget and 36% two budgets prior. Only 18% and 10% of these innovations were introduced in the immediate post-election budget or two years hence respectively. In short, policy initiatives have clustered around elections, with tax hikes having generally followed elections and tax concessions having invariably preceded them.

It is also important to note the distinct variation in what could be termed the 'degree of caution' associated with the timing of tax increases and decreases of the different tax instruments.

This disparity is particularly evident in the case of income tax. Here the trend indicates that most income tax concessions (71%) have been bunched around the pre-election phase budgets (t-4 and t-3), whilst most income tax increases have accumulated in the post-election budgets (t-1 and t-2). Put another way, relative to all other tax changes, comparatively few income tax increases have been instituted in budgets prior to elections, and relatively few income tax decreases have followed in budgets immediately following elections.

In terms of the electoral tax cycle hypothesis, the additional discretion afforded to the scheduling of income tax changes is not inconsistent with the previous analysis concerning the distribution of the tax burden. That is, since income tax is probably the average (median) voter's best estimate of his total tax bill, government has remained extremely cautious in its scheduling of tax rate increases so as to minimize the political costs associated with revenue collection. Similarly, government

has also remained aware of the potential short-run gains to be had from pre-election tax concessions.

The same sensitivity appears to have applied in the case of sales duty and GST. Although most changes applied to sales duty, the government's approach to managing the scheduling of these changes, indicated a distinct preference to allocating tax rate increases in the post-election phase, and tax rate decreases to the pre-election phase - 70% of concessionary sales duty changes came prior any election, and 65% of increases in sales duty and GST were announced in the budget period immediately thereafter.

To a lesser extent, this has also been the case with the scheduling of customs and excise increases. By far the most numerous of changes, almost 76% of these increases have come in the post-election budgets. This indicates a distinct preference by government to hold over both customs and excise increases to the post-election period.

On the other hand, the scheduling of company tax rate increases and decreases displayed the least degree of caution in timing. Of the 14 increases and 8 decreases no discernable trend or 'bunching' was evident.

The most likely explanation for this is as follows: because company tax is generally regarded (although incorrectly) as a burden borne exclusively by companies themselves, government has been able to increase tax rates, without having to concern itself with the possibility of voter discontent. That is, few taxpayers/voters perceive increased taxation of companies as

either adding to, or reducing their individual tax burdens. Nor, as Bartlett (1973) states do companies vote.

What is clearly evident, however, is the manner in which company tax rates have been increased. Consistent with what the public administration literature refers to as incrementalism, government has succeeded in reducing the visibility of these changes by frequently 'edging up' the statutory rate from 20% to 50% in forty years using a complicated mix of marginal adjustments in the 'normal' tax rate, surcharge and loan levy.⁹

Taking a broader view, it is also clear that, government has been far more cautious in its pattern of new tax adoptions and tax increases, than it has been for tax reductions and tax abolitions. Whilst the former portray a fairly distinct pattern (40;26;14;19) showing sensitivity to the election period, the latter (18;10;36;35) do not exhibit the same degree of caution in timing.

Whilst undoubtedly other factors also play a role, this asymmetry can possibly be ascribed to at least two factors. Firstly, many tax reductions have simply followed end of year fiscal surpluses, themselves a function of random revenue shocks (e.g., gold 'booms'). The concessions produced have thus ultimately reflected

this. Secondly, although the argument is a little strained, it could also be said that governments' caution in this regard relates to the fact that the expected political costs associated with tax increases, are likely to outweigh the political benefits associated with tax concessions. That is, individuals are tax averse and are, therefore, more likely to recall previous tax increases than they are likely to remember any tax benefits.

In conclusion, subject to the limitations highlighted earlier, the evidence suggests that the timing of tax rate changes and policy innovations are strongly correlated with the electoral cycle. Consistent with Breton (1974), the electoral tax cycle hypothesis appears to explain the scheduling of these announcements, especially those concerning income tax, sales duty and customs and excise. Tax increases have generally come after elections with tax decreases preceding them.

It should be stressed, however, that the above analysis does not argue that these tax innovations would not have been introduced, or that existing tax policy would have turned out substantially different. What is argued is that the electoral period has simply allowed for the introduction and management of rates that, in the absence of such a 'shield', would have been costlier in terms electoral support. In this sense, one can say that although taxpayers have generally remained insensitive to tax issues, government has, as in the case with income tax, scheduled

tax announcements in a manner consistent with vote-maximizing behaviour.

Government expenditure

As stated earlier, government expenditures must play a role in determining the exact nature of the budget. These expenditure considerations would include such factors as public service salary increases, subsidies, pensions, grants, etc., all of which ultimately determine the net effect of the budget. In the final analysis, some critics might argue that they are more significant. A complete assessment of the electoral budget cycle would, therefore, have to incorporate expenditure considerations into the analysis.

Although largely outside of the scope of this thesis, a first step in this direction has been taken. The 38 budgets in the period were broadly divided up into three main 'types', 'relief' (mainly tax concessions and increased expenditure), 'neutral' (mixed) and 'tough' (mainly tax rises and decreased expenditure).

Viewing the results with the necessary caution, the following trends are evident (Table 4.3:iii). Firstly, 37% of 'relief' budgets came prior to elections, 31% two years prior and only 7% in the post-election period (t-4). Secondly, 'tough' budgets followed an opposite trend with over half (53%) coming in the post-election period (t-4) and only 17% prior to any election (t-1). Lastly, 'neutral' budgets, of which there were 9, displayed no clear tendency with perhaps more occurring in the pre-election phase.

Thus, in conclusion, as in the case of tax announcements, the total budget has remained sensitive to the election period. Consistent with the broader notion of the political business cycle, 'relief' budgets have come prior to election periods and 'tough' budgets thereafter.

4.5 Fiscal Illusion and the Choice of Tax Instruments

According to the public choice approach, vote-maximizing politicians will continually try to reduce the average voter's perceived tax burden by incorporating fiscal illusion devices

into the tax system. It is hypothesized that government can in this way achieve a higher level of expenditure whilst at the same time minimizing taxpayer/voter discontent.

Fiscal illusion is thus directly concerned with the visibility of the tax system, the level of which depends upon the types of taxes used, the timing of tax assessments and the general complexity of the system. More specifically, public choice theorists argue that taxing authorities will generally favour the increased utilization of indirect taxes, tax collection systems which are based on monthly as opposed to yearly tax assessments, and tax schedules which remain sensitive to the effects of fiscal drag.

To find support for the fiscal illusion hypothesis, however, requires both the identification of fiscal illusion 'symptoms' in policy initiatives, and proof of intent.

In the case of South Africa, the major tax initiatives most likely to correspond with the fiscal illusion schema would undoubtedly comprise government's efforts to 'restore the balance' between direct and indirect tax. The introduction of sales duty in 1971 and its subsequent evolution into GST in 1978 are the most powerful manifestations of the government's desire to restore Gladstonian equality, with the latter being the more successful in terms of revenue collections (see Table 2.4). Importantly, they were both initially introduced as 'revenue neutral', the main intention being the reduction of income tax at the expense of a higher indirect tax bill.

From a fiscal illusion point of view, therefore, the shifts from

direct taxes to indirect taxes clearly represent shifts away from 'visible' taxes to 'less visible' ones. Consistent with the 'law of small numbers', individuals are less liable (able) to identify the full burden of their tax bill if it is paid frequently in cents at the till, than if it is paid relatively less frequently (monthly or yearly) as a direct payment or deduction from income earnings.

At the same time it may also be argued that the comparatively low visibility of indirect taxes has enabled government to raise the effective tax rate of low income groups, whilst at the same time minimizing electoral risk. As stated earlier, government has always remained hesitant to raise taxes from low-income groups directly via personal income tax. The emergence of sales duty and GST, has enabled government to do this indirectly. In short, since direct taxes have always been less popular, the answer to growing expenditure requirements has been found in expanding the system of indirect taxation.

According to Krogh (1969:228), this approach to the taxation of the low income groups has in fact been an integral part of tax policy philosophy throughout the post-war period. Citing both the 1945 Council recommendations as well as the Franzsen Commission proposals as evidence, Krogh argues that both of these policies were 'designed to achieve higher average rates of tax for the lower income groups without raising marginal rates of progression for the high income groups, or even to reduce these'.

On the basis of this analysis, the same can naturally be said for the incorporation of GST in 1978. Introduced as a means of

reducing punitive income tax rates, GST essentially represents a flat rate of tax on disposable income, the incidence of which falls most heavily on the low-income groups.

In purely fiscal illusion terms, therefore, the introduction of sales duty, its transformation into GST, and the increasing reliance on the latter since 1980, can be interpreted as the least visible way, and, therefore, the most politically cost-effective means of raising the relative tax contribution of the low income groups. Moreover, consistent with the analysis developed earlier, GST has also offered government a less visible way of taxing the bulk of NP supporters, many of whom prior to 1976 paid little income tax, but who have since been slowly facing rising and higher direct income tax bills.

To state categorically that shifts from direct to indirect tax reflect government attempts to introduce fiscal illusion into the system is, however, difficult to substantiate. It is especially so in a developing country such as S. Africa in which there are a limited number of options available to the taxing authorities. As discussed in Chapter 3, the shortage of additional tax bases, the saturation of existing ones and growing expenditure requirements may simply have forced government to use the tax bases available, thereby incidentally reducing visibility.

Doubt about the fiscal illusion view was enhanced by government's 1985 decision to enforce an add-on, and not an add-in system for GST.

To recap: prior to 1985, the tax law regarding the charging of

GST gave traders the option to use either an add-in system or an add-on system. In the former, the tax component is included in the price of goods as advertised, whilst in the latter the tax is added on separately at the point of sale. The crucial difference between the two lies in the fact that under the add-in system the exact tax burden is not easily identifiable from the total purchase price, whilst in the latter it is clearly visible which portion of the total price constitutes 'value' and which portion constitutes 'tax'.

In 1985, however, with the passing of the Sales Tax Amendment Act, government opted to enforce the add-on system of GST calculation. Whether this policy decision was an error (at least in fiscal illusion terms) or if it was an administrative issue is not determinable. What is clear, though, is that GST under the add-on system became far more visible than had been the case before.

The decision to opt for an add-on system has, therefore, had its costs. For example, Collinge (1986:255) notes that in the November 1984 Pretoria-Witwatersrand-Vereeniging stayaways, regarded as the most successful of their kind since the 'fifties, the abolition of GST and other 'unfair taxes' were among the economic demands made by workers. In another report, it was claimed that some Blacks believed that most taxes, especially GST, went directly toward maintaining the police and defence force (see, Daily Despatch, January, 1, 1983).

Admittedly, whilst an add-in system may not have eliminated this perception entirely, the former, rather than an add-on system,

would undoubtedly have gone some of the way to reduce the negative sentiment expressed by the Black population toward GST.

Indeed, for this and other reasons, the Secretary for Department of Inland Revenue had originally, during GST's inception, come out strongly in favour of an add-in system with the aim of reducing its visibility. In his own words:

"There is another factor which has influenced my views on the add-in and that is the buying habits of the Black people.....if a Black customer takes an article marked R1, there will be a lot of unnecessary argument if he is told at the counter that he must pay R1,04."

(Van Der Walt, D., 1978 p.1).

Today, GST stands at 12%, and although certain 'basic' commodities have been excluded, the major obstacle to further increases in it, and indeed to its continued existence, lies in the considerable Black (and White) opposition toward it.

Particularly relevant, therefore, are rumours, spread on by ministerial statements, that government, on advice from the as yet unpublished Margo Commission on Taxation, will scrap GST and replace it with a VAT in the near future (see e.g., Cape Times, Aug. 1, 1986). If true, then in terms of the fiscal illusion hypothesis, they may be interpreted as government's answer to rising discontent with the tax system and specifically GST. By adopting a far less visible VAT, the average consumer's perceptions of the tax bill will be drastically reduced.

Under an inclusive VAT, the burden of the tax is spread out over the complete line of production, distribution and consumption so that final prices do not reflect which segment of the price is

the value of the good, and which is the tax component. Moreover, the likelihood of 'hassle-free' future rate increases are stronger than under GST, since adverse consumer/voter reaction will certainly be less. This would be especially valid in periods of high inflation during when changes to the VAT rate would become inextricably bound up with a general rise in prices.

As stated above, different methods of collection also play a significant role in determining the perceived burden of the tax bill. In the case of S.Africa, the PAYE system, in particular, has probably been the most successful fiscal illusion device ever introduced by government. This is because since individuals never receive the income in the first place, the perceived burden is considerably reduced. In addition, the burden is spread over 12 months removing the annual tax assessment/accumulation problem.

Following on from the latter point, it can also be argued that PAYE deductions schemes have indirectly enabled tax rates to persist at average rates of 40%, which without an efficient PAYE, would probably not have been either economically or politically possible. At today's high average tax rates, few individuals would be able to set aside sufficient funds to meet their annual tax assessments. As one local source puts it:

" Unless the employee has during the year set aside money from time to time sufficient to meet his income tax, he finds himself - as many a taxpayer does, with a comparatively large income tax bill and no money with which to pay it.....A PAYE system, therefore eliminates the yearly problem....."
(The Taxpayer, 1955, p.38).

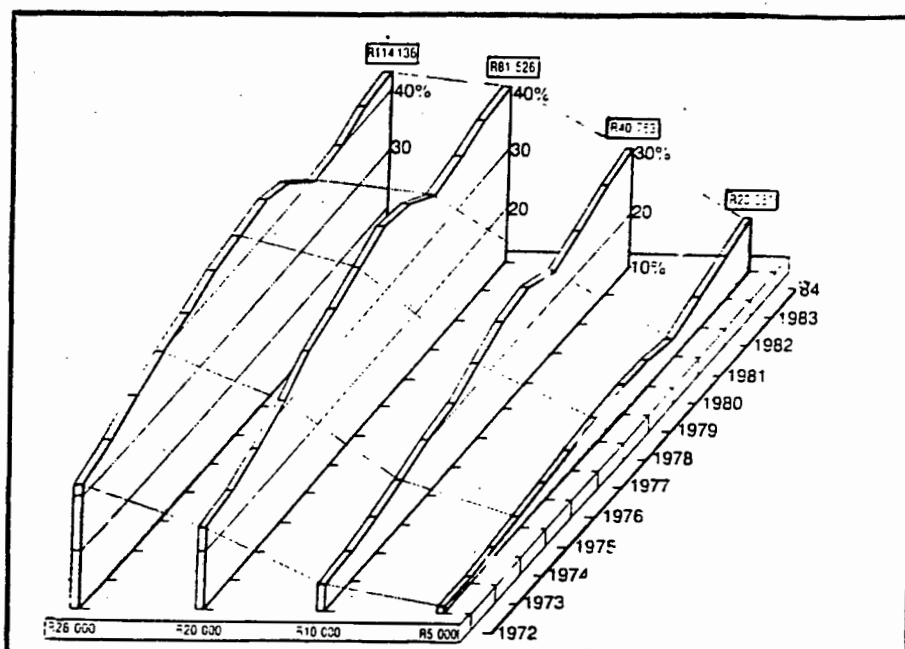
In the same way, the Final PAYE deduction scheme serves a similar 'illusory' purpose. Not only does the PAYE system of deduction eliminate the yearly accumulation problem, but the Final PAYE scheme obviates the need for an annual assessment. This reduces taxation to the status of a monthly contribution at work, unseen and seldom aggregated.

Providing proof of intention is again problematic. That is, the argument that PAYE was introduced as a means of reducing the visibility of the system must be viewed against the more likely explanation that purely administrative factors involved. As discussed in Chapter 3, a PAYE system not only reduces the costs of collection for the taxing authorities, but also creates a more consistent cash flow for the Treasury, neither of which are related to fiscal illusion. Similar cost of collection arguments are very persuasive in the case of the Final PAYE deduction scheme.

Where the benefits accruing from fiscal illusion have most certainly been utilized, however, has been in the 'management' of income tax rates. Specifically, the government's unwillingness to index the tax system has enabled real average tax rates to rise automatically over time without the need for statutory action (see MacGregor, 1979). Consistent with the fiscal illusion hypothesis this 'neglect' has allowed revenues to rise surreptitiously over time, whilst at the same time permitting government scope to introduce practically meaningless marginal rate and starting level 'concessions'.

The degree to which fiscal drag has affected average tax rates

for different income groups over the period 1972 to 1984, is clearly depicted in Figure 4.1 below. Here it can be seen that households earning the equivalent of R5000 in 1972 Rands, paid away 10.4% of income to tax in 1972, 14.8% in 1979 and 19% in 1984. The middle income groups earning constant 1972 R10000 Rands in 1972 paid 24.9% in 1979 and 30.9% in 1984. On the other hand, the very high income earners did not suffer to the same extent (i.e., since they paid the maximum rate already) but nevertheless saw their average tax burden for a constant R28000 Rands rise from 31.4% to over 40% in 1984.



Source: Lombard, 1984:6

FIGURE 4.1 NORMAL TAX RATES ON DIFFERENT REAL INCOME LEVELS, 1972 -1984

Lastly, as will be discussed in Chapter 5, practically no attempt has been made by government to rely on the illusory effects of increased deficit financing and debt. Table 5.3 (Chapter 5) reveals that in contrast to the view expressed by Buchanan and Wagner (1977), the size of the deficit and hence the stock of public debt have not increased over time, but have actually fallen in relative size over the last decade.

To sum up: the introduction of sales duty, its evolution into GST, PAYE, the Final PAYE deduction scheme and the unwillingness to index the tax system are all, from a fiscal illusion point of view, potential manifestations of the government's desire to reduce the visibility of the tax system. The strong likelihood that government will scrap GST in favour of VAT would also appear to confirm this. On the other hand, the decision to opt for an add-on GST, the general shortage of feasible tax bases available to policy planners, and the strong administrative arguments behind the introduction of PAYE, counteract this view. In light of these conflicting arguments, the whole fiscal illusion argument becomes a debatable issue for which no clear conclusion can be reached.

4.6 Conclusions

Clearly, whilst the emergence and availability of tax bases and 'handles' remains a product of economic development, decisions about which bases to actually use, and certainly which to use more than others, is primarily determined in the political sphere. The public choice approach, therefore, by highlighting the role that political factors play in the determination of tax policy, provides some valuable insights into the evolution of the South African tax structure.

The degree to which political factors affect the distribution of the individual income tax burden are particularly noticeable. Consistent with government's vote-maximizing objectives, the evidence presented strongly supports the view that the

distribution of this burden, at least until 1976, has been clearly designed to load the high-income predominantly English speaking minority with high tax bills, in favour of the numerically and politically more influential low-income Afrikaner majority. In addition, the farming community has, as a result of its disproportionate parliamentary representation, received a highly beneficial tax policy reflecting its crucial role in the electoral numbers game.

To a large extent, the timing of tax announcements has also reflected these vote-maximizing objectives. Section 3 of this chapter provides evidence to support the view that the timing of tax announcements has not been ad-hoc, but instead has followed a predictable path strongly consistent with the electoral tax cycle hypothesis. Tax increases have generally come after elections, and tax concessions before.

Over the last fifteen years government has also implemented a number of tax initiatives aimed specifically at placing greater reliance on indirect taxation. PAYE and fiscal drag have also played a major role in reducing the overall visibility of the tax system. Despite this strong circumstantial evidence, however, one cannot be categorical in arguing that government has deliberately followed a policy aimed at introducing fiscal illusion into the system.

PART THREE: (CONT.) INTERPRETATION

CHAPTER FIVE: EVALUATING THE MARXIST APPROACH

5.1 Introduction

The marxist approach to tax structure change holds that tax changes reflect changes in the underlying social structure. On the one hand it is argued that since the State reflects the preferences of the dominant capitalist class, the tax system will be designed around the promotion, maintenance and protection of capitalist interests. On the other hand, it is also claimed that an exploited working class bears a disproportionate share of the tax bill, reflecting its role in providing surplus value for profitable accumulation in the corporate sector. Lastly, some marxist theorists contend that the inability of these two forces to persist simultaneously over time, inevitably results in expenditure requirements outpacing revenue capacity, leading to a fiscal crisis and collapse of the State.

This chapter evaluates these arguments, dividing the analysis into three main sections. The first investigates the taxation of the capitalist class. Section II follows with an evaluation of the nature of taxation vis à vis the working class. The concluding section presents a brief enquiry into the question of 'fiscal crisis'.

Before developing the analysis, however, two constraints within the literature need to be highlighted. Firstly, with the possible exception of Kaplan (1977), marxist writers on the South African situation have devoted very little time to taxation and even less to broader public finance issues. Secondly, marxist

analysis implicitly operates from a high degree of abstraction, with the result that a neo-classical evaluation of marxist concepts invariably encounters severe definitional (e.g., exploitation) and identification (e.g., working class, capitalists) problems. Consequently, whilst the aim of this chapter remains the evaluation of these arguments, it would be realistic to recognise that it can only be considered as a first step towards understanding some of the factors affecting the nature of taxation from a marxist perspective¹.

5.2 Taxation of the Capitalist Class

As stated above, a central tenet of the marxist approach holds that since the State reflects the preferences of the capitalist class, the tax system will be designed primarily around the promotion, protection, and maintenance of capitalist interests.

This section evaluates this aspect of the marxist perspective focussing on four separate themes; company taxation, mining company taxation, mechanization, and the taxation of wealth.

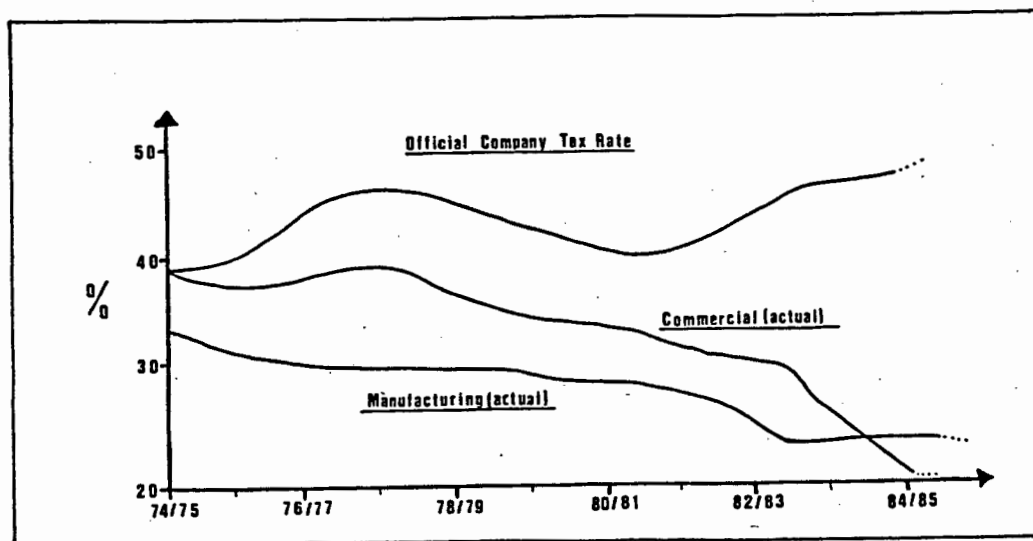
i) Company Taxation

Implicit in much of the marxist literature (e.g., Woodside, 1982) is the belief that in modern capitalist economies, capitalists operate through, and accumulation takes place, primarily via the medium of the limited company. Being the cornerstone of the capitalist system, the corporate format provides the basic vehicle for free enterprise, and the institutional framework for the initial mobilization of funds. In addition, the company apparatus is made considerably more attractive by i) an accomodating legal system which protects

investors from personal loss by guaranteeing limited liability and ii) by the ability of companies to forward assessed losses to future years for tax purposes.

It follows from the above that if State actions do indeed reflect the preferences of the capitalist class, then evidence to support this should be readily apparent from an analysis of corporate tax policy. Specifically, one would expect the 'real' company tax rate to be either low (relative to other taxes), or lower than the 'statutory' rate, reflecting the unwillingness of the State to hinder profitable accumulation in the corporate sector.²

Examining the S. African data, this hypothesis would appear to have some support, especially if one considers the period 1974 to 1984. Figure 5.1 (below) illustrates that despite a rise in the 'statutory' tax rate from 40% to 50%, the 'real' company tax rate (i.e., tax receipts as a percentage of company profits - dividends) has throughout this period been consistently below this official level, falling to as low as 20% in 1984/85. This is partially confirmed by the fact that over this same period, company tax returns actually fell in real terms, as well as in terms of their share of total revenue collections (see Figure 3.2)



Source: Financial Mail, Sept, 1983:3

FIGURE 5.1 THE OFFICIAL, COMMERCIAL (ACTUAL) AND MANUFACTURING (ACTUAL) COMPANY TAX RATES, 1974 TO 1984.

Whilst a number of factors has undoubtedly played a role, the underlying cause of this disparity in rates can essentially be ascribed to the effect that various allowances (concessions) have had on the determination of taxable income (TI). That is, whilst all companies have generally paid the statutory rate of tax on taxable income (e.g., presently 50% x TI), it has been the cumulative effect of the concessions involved in the actual calculation of this 'income' which have ultimately reduced taxable profits, manifesting themselves in low 'real' tax rates. As Divaris puts it:

"...there can be no question about the reason why there is such a wide discrepancy between corporate taxable incomes and accounting profits: the tax concessions available to business are very considerable, and in SA business is incorporated."
(Divaris, C., 1985a, p.60).

Putting forward the costs of these allowances as part of the rationale for scrapping the investment allowance, the De Loor Commission (W.P.H./1983) also stressed exactly this point. In their own words:

"The practice of using the three..(i.e., the initial, investment and cash subsidies)..in combination, seems costly in terms of revenue forgone, and is reflected in the low average effective rate of company tax compared to the statutory rate."
(De Loor, J., 1983, p.6, emphasis added).

The data released by the Commission confirm this. Table 5.1 (below) reveals that for the period 1975 to 1981, the 'guestimated' cost of taxes forgone (on manufacturing and taxpaying public corporations) as a direct result of the investment and initial allowances rose 49.7% (in real terms) from R488 million in 1975 to R1476 in 1981, corresponding to 33.6% and 47.2% of actual company tax paid. In other words, these concessions (the reasons and results of which are discussed

later), together with numerous cash allowances, substantially reduced the yield of the company tax base by lowering the 'real' tax rate for many profitable companies. In addition, not only did allowances and concessions raise corporate post-tax profits but they also contributed to the distortion of relative factor prices and thus a capital/labour mix highly inappropriate to S. Africa's comparative advantage (Biggs, 1982:27).

YEAR	1975	1976	1977	1978	1979	1980	1981
PRIVATE MANU. TAXPAYING P.C.*	379	416	366	432	499	751	970
TOTAL	488	491	443	626	727	1225	1476

Source: De Loor, 1983:5-6

TABLE 5.1 ESTIMATES OF TAX FORGONE AS A RESULT OF THE INVESTMENT AND INITIAL ALLOWANCE IN RESPECT OF MACHINERY AND BUILDINGS IN THE MANUFACTURING SECTOR (Rm), 1975 - 1981.

Costly incentive allowances also characterise the tax years 1980/81, 1981/82 and 1982/83. A more detailed Table 5.2 (below) shows that over this period, fiscal incentive allowances, also known as tax expenditures, accounted for some R976m, R504m, and R1410m or 40.3%, 37.2% and 27.4% of total non-mining company tax returns respectively. Also clearly evident from the table

FISCAL YEAR	1980/81	1981/82	1982/83
Machinery inv. allow	443.52	187.08	525.87
Machinery in. allow	379.26	173.16	444.88
Exporters allowance	73.50	62.85	201.49
Training allowance	32.34	32.70	115.97
Other	47.46	49.15	122.65
TOTAL	976.08	504.94	1410.86
% share of total company tax paid	40.3%	37.2%	27.4%

Source: Budget Statistical Reviews, 1984/85-1986/87

TABLE 5.2 COMPANY TAX EXPENDITURES (Rm), AS A % OF COMPANY TAX PAID, 1980/81 - 1982/83

is that the bulk of these allowances comprised investment and initial allowances in the manufacturing sector, with exporters and training allowances accounting for only 20%. In other

words, although other deductions certainly played a role, the policy of subsidizing the cost of capital enabled many profitable companies, in particular gold mining companies, to reduce their tax liability simply by incurring additional capital expenditure.

General companies too have benefitted from these and other tax concessions. Indeed, so widespread is the use of these allowances, and so sophisticated is the art of tax avoidance that the Minister of Finance has even gone so far as to maintain that careful analysis of published company reports indicate that to date, many profitable companies pay 'little tax or no tax at all' (Hansard, March 28, 1984, c.3892). Or, as Divaris puts it:

".....very seldom are complaints heard about the corporate rate of tax. The main reason that this rate is not a burning issue in fiscal policy is that despite their high nominal liability, companies actually pay very little tax."
(Divaris, C., 1985, p.60, emphasis added).

In addition to capital incentive allowances, the promotion and protection of capitalist interests in the corporate sector can also be said to extend to a number of other aspects of corporate tax policy.

Possibly the most significant of these relates to the tax treatment of undistributed profits. Always a contentious issue, the UPT, essentially a tax on company wealth, has had a very sketchy history having been abolished (1952, 1960) and introduced in different forms (1941, 1955, 1969) on no less than five separate occasions. More importantly though, despite it's apparently high rate (33,33%) payable by all companies (other than mining companies and close corporations), a number of critics argue that the

manner in which the UPT has been enforced, has literally ensured that companies have been able to accumulate vast surpluses of undistributed profits tax free. To quote one source:

".....because of the way that liability for this tax is calculated, all companies are effectively free from liability for the undistributed profits tax on their South African operating profits....."
 (Divaris, C., and Stein, M., 1985, p.166, emphasis added).

This argument is partially³ confirmed in Table 5.3 below. Here it can be seen that over the period 1969 to 1985, total UPT collections at no time amounted to more than R6.8m (less than 1% of Ordinary Revenue), making it one of the most negligible sources of income in the entire revenue structure. The levels are particularly astounding if one considers that the base for UPT comprises the undistributed profits of almost the entire corporate sector! Noticeable too is the low and falling UPT returns over the period 1980-83, when over this same period, one would have expected that high inflation rates forced many companies to limit dividends to a minimum in order to retain sufficient funds for capital replacement.

FISCAL YEAR	Rm	FISCAL YEAR	Rm	FISCAL YEAR	Rm
1969	1.4	1974	4.3	1979	4.5
1970	2.4	1975	5.9	1980	4.2
1971	2.5	1976	5.9	1981	2.4
1972	2.0	1977	6.8	1982	2.5
1973	3.8	1978	5.0	1983	2.3

Source: Inland Revenue Annual Reports, 1969-83

TABLE 5.3 UNDISTRIBUTED PROFITS TAX (UPT), IN R.MILLIONS, 1969 TO 1983.

This 'hands-off' approach to undistributed profits has important implications for dividend policy. Instead of distributing after-tax profits to shareholders (on which high income taxes could be payable), the mild enforcement of UPT has provided

stockholders with a relatively easy way of accumulating wealth tax free via private and public companies. In the case of the latter, this policy has implied even further advantages to owners of corporate stock since larger withholdings of profits eventually reflects in higher share prices, the profit on the sale of which does not attract any form of capital gains tax.

More recently, the unwillingness on the part of the State to enforce UPT emerged in Section 50(aC) of the Income Tax Act. This section of the Act exempts Close Corporations (CC) from UPT, with the result that conversion of an existing holding company to a CC gives rise to substantial tax savings. For example, an investment holding company in receipt of dividend income has to pay UPT or declare dividends on which tax is payable. Yet, since a CC is itself exempt from UPT, any wholly owned subsidiary of the CC is similarly exempt. Thus, by simply converting an existing holding company into a CC, 'it is.....possible to trap dividend income in the investment company and still avoid UPT (Mazansky, 1986:17, my emphasis).

Lastly, the State's accomodative approach to the taxation of the corporate sector has extended to its method of collection. This was particularly evident in the 1952 decision to scrap the private company apportionment system. Introduced in 1941, the apportionment system was so successful in terms of increased revenue collections that the State eventually abandoned it in favour of the present system which clearly enables easier accumulation of tax-free wealth. In fact, when providing part of the rationale for the scrapping of the apportionment system, the Minister of Finance stressed exactly this point:

"While this system.....provides.....an effective means for ensuring that the formation of companies is not used for the purpose of avoiding taxes, it imposes serious hardship on shareholders in private companies which are not formed for this purpose and discourages the formation of capital."
(Hansard, 1952, vol.78, c.3430-1, my emphasis).

To conclude: to focus on statutory tax rates alone is a poor indication as to what has happened in corporate tax policy. Contrary to the trends suggested by statutory rates, the effect of fiscal allowances on taxable incomes, the apparent reluctance on the part of the State to strongly enforce the UPT, and the method of tax collection together provide evidence to support the view that aspects of corporate tax policy have been advantageous to corporate profits. In this sense they have been reflective of capitalist interests. This would of course be subject to the proviso that corporate holdings can be said to be owned wholly or predominantly by the capitalist class.

Similar conclusions cannot, however, be drawn about other aspects of company taxation. This is because a number of policies have clearly prejudiced and inhibited corporate profits and growth.

Possibly the most significant of these policies relates to the taxation of so-called 'paper-profits'. These emerge during inflationary periods as a result of the inability of contemporary accounting to provide a means for ensuring realistic economic depreciation deductions. These so-called 'profits' are thus inflated with the result that any tax on these 'profits' is effectively a tax on capital itself, which cannot in any way be said to have encouraged corporate expansion. Similarly, if capital invested is depreciated at replacement cost instead of

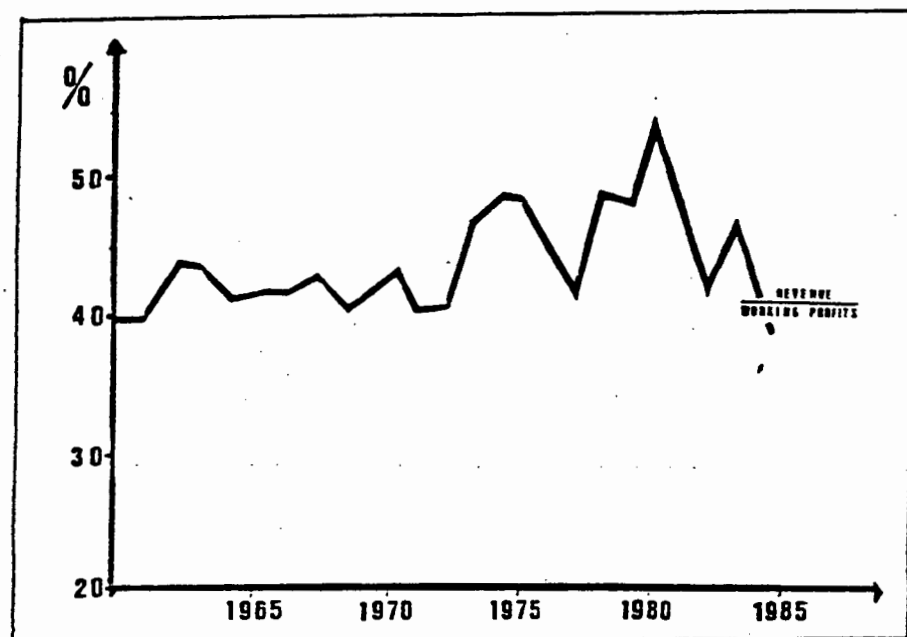
historic cost, the real company tax burden over the last few years would have been substantially higher due to the inflated prices of capital goods. Other distinct tax disadvantages unique to companies include; the taxation of distributed dividends, the treatment of share dealing, and policies regarding the taxation of assessed losses and borrowed money, all of which clearly discriminate against companies (Broomberg, 1978:11-14).

The capital incentive allowances which have acted to reduce taxable incomes have also not been evenly distributed - whilst they have generally acted to reduce tax bills, they have also discriminated within the corporate sector itself. This is because when company tax rates have been raised, 'big business' (mining, industrial, farming, hotel etc.) has generally been better positioned than smaller concerns (wholesale retail etc.) to take full advantage of the available tax shelters and tax shields. For small businesses, therefore, the 'real' tax rate has often come close to the statutory rate severely inhibiting corporate growth (Divaris, 1985b:95)⁴. Unfortunately, what these 'average' rates are for different companies is not readily calculable, since the statistical information required for this purpose is not available (see Hansard, 'Q&R' Feb. 23, c.321-2).

ii) Mining Taxation

A major exception to the policy of low tax rates for the corporate sector has been the high rates applied to the mining sector. Figure 5.2 (below) reveals that the 'real' mining company tax rate (i.e., mining taxation as a % of working profits) has remained consistently above 40% throughout the period 1961 to 1985, and, therefore, consistently above both the

'real' and statutory rate applied to non-mining companies. The Chamber of Mines (COM) has in fact on occasions put these rates at levels of 65% and more (see COM, Annual Reports: various). In addition, unlike non-mining companies, mining companies have not been able to pass any of the tax burden on as higher prices, being effectively pure price takers.



Calculated from Chamber of Mines Annual Reports and Columns 6 & 9 of Table A

FIGURE 5.2 : GOLD MINING COMPANY TAX AS A PERCENTAGE OF WORKING PROFITS, 1960-1985.

Yet, whilst this pattern of high tax rates on the mines appears to contradict the earlier analysis regarding favourable treatment of companies, some marxist theorists argue that this high level and discriminatory rate of taxation is still wholly consistent with a marxist interpretation.

Possibly the most authoritative of these works is Kaplan's (1977) seminal contribution on the role of the State. Putting the State at the heart of the debate, Kaplan argues that throughout S. Africa's history the State has unequivocally promoted the emergence and development of capitalist production relations (i.e., capitalist interests). At the same time though, he maintains that while safeguarding capitalist production, the

State has 'interfered' where necessary in order to maximize the long-run interests of capitalist production as a whole, even if such intervention was contrary to the interests of a number of capitalist fractions (e.g., mining capital, manufacturing capital etc.). This 'intervention' often took the form of redistribution of surplus via the budget.

Within this framework, Kaplan argues that it is possible to interpret the development of gold mining tax policy, the basis of which was laid down in the 'thirties.

Briefly, Kaplan maintains that with the start of Pact government in 1924, 'national' capital (mostly manufacturing and agricultural capital) wrested political hegemony (dominance) away from 'foreign' or 'mining' capital. This change in political (although not economic) hegemony manifested itself in changes in the State's taxation policies.

Specifically, Kaplan argues that when 'national' capital assumed dominance, redistribution from the mining sector via the tax system became the principal means through which surplus became available for profitable capital accumulation in other sectors. In his own words:

" An extensive and sustained redistribution of gold mining profits via the mechanisms of State taxation policies, played a critical role in the process of capital accumulation in all other sectors of the economy - including critically agriculture and to a lesser extent secondary industry." (Kaplan, D., 1977, p.276).

Kaplan suggests, however, that the degree to which this redistribution could be carried out prior to 1932 was extremely

limited as a result of a low gold price. It was, therefore, only with devaluation (1932), and later 'Fusion' government that increased discriminatory taxation of the mines finally took off. As described in Chapter 2, this increase took the form of an 'Excess Profits tax'. This resulted in the rate of taxation on gold mining companies rising from being only 1/5 more than ordinary companies in the Pact period to five times (5x) more in the Fusion period (Kaplan, 1977:262).

Kaplan asserts that despite massive opposition from mining capital, the policy of differential taxation was even more heavily enforced during the war years and then again subsequently following on after the Holloway Commission Report (see p.85-89).

Similar points, although somewhat less well developed, have also been forwarded by Legassick (1975b:252-270). Emphasising the relationship between various capital fractions until the late 'twenties, Legassick argues that from as early as 1875, the State played an active and integral role in diverting part of the mining surplus to finance agricultural development. This in turn contributed towards agriculturally-based capital's later success in manufacturing, commerce and mining. In his own words:

" In the early stages of industrialization...
....Capital based in agriculture.....found
itself unable in a 'free market' situation
to diversify into manufacturing, commerce or
mining....from the 1930's agricultural-based
capital....began to mobilize to gain entry to
such fields. Already from the early 1920's
and earlier, rural cooperatives and separate
financial institutions for agriculturalists
(SANLAM, etc.) had provided means for capital
accumulation out of the surplus diverted from
mining to the farms."
(Legassick, M., 1975b, p.258).

More to the the present, Kaplan argues that the State has generally accepted and advanced the view of mines as a 'wasting asset'. On this basis it has continued to enforce a discriminatory tax policy aimed at diverting surplus from the mines to other sectors of the economy regarded as of more 'permanent' duration.

In this sense, Yudelman (1984:279-289) echoes these views. Although not as comprehensive an analysis as that of Kaplan, Yudelman argues that the 'symbiotic relationship' formed between the State and Capital during the 'thirties was instrumental in determining present day policy. Like Kaplan and Legassick, therefore, Yudelman argues that this relationship has persisted throughout the post-war period and has thrust the mining industry into the role of provider of surplus for other sectors of the economy during good times, while remaining as a 'vital lynchpin' to be protected during bad times.

To sum up: to some extent the pattern of higher taxation of the mining sector contradicts the marxist prediction. This same discriminatory taxation, is, however, not inconsistent with the marxist capital fraction argument, which correctly identifies the mining sector as the source from which profitable accumulation in other sectors has been financed.

iii) Mechanization

According to a number of marxist writers, one of the central functions of the tax system under capitalism is to provide the legislative means (tax 'breaks') to enable capital intensification and increased mechanization. The reason for this is as follows: during the course of economic development, the

demand for labour invariably rises causing a rise in its price. A rise in real wages implies a fall in the rate of surplus value, and, therefore, a fall in the rate of profit. To maintain historical rates of profit (or even to increase them) and international competitiveness, some marxist theorists argue that the State provides capitalists with the necessary legislation to facilitate the introduction of machinery and other labour-saving devices. The effect of this substitution is to reduce the demand for labour (at least in the short-run), lowering its price and in so doing raise the rate of surplus value and profit enabling further accumulation.

Similar arguments have been raised in regard to the South African experience, especially with reference to the mining and manufacturing sectors. Here taxation policies⁵ have clearly been designed to enable the process of increased mechanization and automation. As Hartwig and Sharp claim:

"Through a variety of fiscal incentives, and other schemes, the State has tried to encourage the trend toward a rising organic composition of capital through mechanization, reorganization and rationalization of the labour process to thereby enhance capital's national and international competitiveness."
(Hartwig, M. and Sharp, R. 1983, p.33, my emphasis).

In possibly a more authoritative study, Legassick (1974) argued that in the period after 1948, the State undertook a policy of rationalization in the secondary industry. Central to this policy was the 'replacement of the artisan-unskilled division of labour by semi-skilled operatives working machines'. This transition entailed both greater mechanization and the promotion of bigger production units.

Legassick further argues that an integral part of this policy pivoted around the need to maintain separate development to protect White workers' jobs from being replaced by cheaper Black labour. The overall plan, at least as it was interpreted by Legassick, was for manufacturing to become more capital intensive as a whole (i.e. throughout the country), yet relatively labour intensive in the homelands and peripheries.

Legassick also maintains that this same policy was regarded as both conducive to economic growth, and also a means through which 'surplus' Black unemployment could be 'transferred' to the homelands. In his own words:

"For a long time government spokesmen have been arguing that capital intensification of industry in the existing industrial centres would permit the displacement of 'surplus' blacks to the reserves/Bantustans."
(Legassick, M., 1975, p.34).

A number of non-marxists have also raised the same point. For example, speaking in 1982, Michael O'Dowd argued that since 1955 the official policy of the State had been non-absorption of the Black population into the urban industrial economy and their repatriation to the homelands. According to O'Dowd, although this policy was never fully implemented, its underlying philosophy nevertheless 'influenced almost every element of government action'. Importantly it led to a wide range of policies primarily designed to 'steer the South African economy in the direction of capital intensive development'. One of the most important of these was the system of capital incentive allowances. As O'Dowd puts it:

"when Government spokesmen were asked how we were going to do without the Blacks they used the answer - 'automation'. It is not by accident that the tax system rewards capital investment and penalises employment." (O'Dowd, M., cited by Biggs (1982) my emphasis).

In this same 1975 paper, Legassick went on further to argue that capital had a strong interest in increasing the capital intensity of the manufacturing process in order to raise worker productivity. In short, Legassick argued that the only manner in which cheap semi-skilled Black labour could be profitably utilized was through increased mechanization of secondary industry. Citing statements made by the Board of Trade and Industries, Legassick thus saw increased mechanization as a means through which maximum gains could be made from low-paid Black labour.

Similar points have in turn been raised by Kaplan (1977). Focussing on the role of the State, Kaplan argues that when South Africa emerged from the war, manufacturing industry was characterised by a large number of establishments utilizing labour intensive techniques. This meant a 'low organic composition of capital' (capital/labour ratio) and, consequently, low levels of worker productivity. According to Kaplan, therefore, the wide range of policies, including a favourable tax policy, are best interpreted as the State's response to capital's needs to raise the productivity of the labour force. Indeed, government itself had on a number of occasions stated that 'taxation policy will be aimed at the encouragement of increased capital formation, since this is an essential requirement for increased production' (Hansard, 1955, Vol.88 c.3215, my emphasis).

A survey of studies done in this area suggests that to a large extent, this policy of encouraging increased capital intensity and mechanization has been highly 'successful'. This has been especially true of the large scale capital intensive industries which have received the most generous benefits. Bloch (1980:113-141) for example, looking specifically at developments in the manufacturing sector between 1946 and 1975 provides some evidence to support the view that the State played an 'important role in facilitating the raising of the organic composition of capital'. Summarising data from a number of related studies, Bloch found that the rise in the capital-labour ratio in manufacturing industry of 1.8% per annum could be attributed to a number of State instituted policies, including critically a protective tariff policy.

A second, and possibly more authoritative study is that performed by Biggs (1982). Taking a broad view across all sectors, Biggs found evidence to support the capital intensification hypothesis. Specifically he found that the 1975 Rand capital cost of the average work place had increased by approximately 3.7% per annum from R6 783 in 1960, to R8 969 in 1970 and to R14 034 in 1980.

More important than the quantification though is the fact that in his analysis Biggs' stresses inappropriate relative factor prices, created by the tax system's schedule of capital incentive allowances, as one of the primary causes of this phenomenon. In his own words:

" Whatever the other effects of these fiscal investment incentives might be, the net effect is to strengthen the bias toward capital intensive production processes by generating relative prices inappropriate to South African conditions."

(Biggs, F., 1982, p.27, emphasis added).

Although unwilling to ascribe the cause of this capital 'deepening' to fiscal allowances only, the De Loor Commission came to similar conclusions in 1984. Using data supplied by the Bureau for Economic Research, the Commission confirmed Biggs' earlier calculations and found that the real capital stock employed had risen substantially from averaging only R5 181 per worker in 1961 to R11 231 in 1980 (1975 prices) reflecting an average real growth rate of some 5.4% per annum.

Whilst the trend in capital intensification is not disputed, its effects on employment levels and wage rates are. Indeed, studies in this area are characterized by bitterly contested divisions on both the theoretical and empirical level. 'For example, Bell's (1978) very solid empirical evaluation of Legassick's hypothesis found no relationship between changes in capital/labour ratios and changes in unskilled and semi-skilled unemployment levels, and, therefore, little evidence to support his argument. Looking specifically at the effects of mechanization on farming employment, de Klerk (1984:22) also concluded that lost jobs were 'to some extent compensated by a rise in industrial employment', although not entirely. On the other hand, Bromberger's (1984:8)

overview maintains that there is 'obvious' prima facie evidence to support the view that in the farming sector, employment has been lost as a result of capital intensification. Undoubtedly though, more empirical work is needed in this area before the effects of capital intensification on employment can be fully determined.

To summarize: in addition to having exacerbated the disparity between statutory and effective company tax rates, the system of capital incentive allowances has provided the legislative means for enhanced automation and mechanization. In this sense it can be said to have reflected capitalists interests, at least to the extent that capitalists can be said to have benefitted from this. Whether or not this same process can also be said to have increased unemployment and depressed wage rates is, however, not as clear, and more research is needed in this area before firm conclusions can be reached.

iv) Taxes on Wealth

The final aspect of taxation of the capitalist class dealt with in this section focusses briefly on the taxation of wealth. Despite definitional problems, a number of marxists point to the absence of taxes on wealth as clear evidence of the true nature of taxation. This assertion has its parallel among local writers who see the absence of such taxes as capital gains and property tax in this same light. As Theron claims:

" the absence of several other taxes commonly employed elsewhere - such as taxes on wealth, capital gains and the taxing of fringe benefits.....would place a heavier burden on the higher income groups, a situation the government has been avoiding for some time."
(Theron, T., 1984, p.13-14).

A brief review of the data relevant to this issue would appear to confirm this. Table 5.4 (below) shows that direct taxes on

wealth (of which the major are Estate duty, Donations tax, Transfer duty, Marketable Securities tax and Stamp duties) have together accounted for a declining and negligible source of government revenue collections (see also McGrath, 1979:12).

FISCAL YEAR ENDING	TRANSFER DUTY	ESTATE DUTY	DONATIONS TAX	MKT SEC TAX	STAMP DUTY	TOTAL
1946	2.8	1.4	Neg	0.0	4.2	8.4
1956	2.4	0.6	Neg	0.2	1.9	5.1
1966	1.4	1.0	Neg	0.3	1.8	4.5
1976	1.1	0.7	Neg	0.2	1.1	3.1
1985*	0.9	0.3	Neg	0.2	2.0	4.7
AVERAGE	1.9	0.9	Neg	0.2	2.0	4.7

*Estimated

Source: Inland Revenue Annual Reports

TABLE 5.4 DIRECT TAXES ON WEALTH, AS A SHARE OF TOTAL REVENUE, AT TEN YEARLY INTERVALS, 1946 - 1985.

The low returns from Estate duty are particularly noticeable. A form of property tax, and a long established tax on wealth, it has throughout the post-war period remained a negligible source of revenue for government, despite a rise in the value of estates. As McGrath puts it:

" The striking feature.....is that the relative importance of estate taxes in total government revenue has fallen dramatically since the 1920's until its yield has now shrunk to almost negligible proportions and in fact decreased in real terms between 1975/76 and 1978/79."

(McGrath, M., 1982, p.53).

This low yield from Estate duty can essentially be ascribed to the high level of abatements that have consistently been maintained over the period in order to avoid fiscal drag effects. For example, at present, the primary, spouse and surviving children abatements are pitched at R50 000, R50 000, and R40 000 (each) respectively, effectively reducing the number of estates liable for tax to a minimum. Indeed, when rates were relatively high in

1957, the Minister of Finance noted in the budget speech of that year that out of 100 estates, a mere 10 were liable for duty.

Estate duty taxes did not, however, always produce such low yields. Close examination of statistics in the 'twenties and 'forties (see McGrath, 1982:52) reveals that Estate duty accounted for up to 6% of Inland Revenue collections, almost 20 times the magnitude today. Yet, continued strong pressure from certain special interest groups, particularly farmers, has reduced these rates since so that currently Estate duty imposes a small burden on large estates and no burden at all on small estates.

The few other direct taxes on wealth in existence have not been as fully utilized as other forms of tax. A good example of this is Transfer Duty on real estate. First introduced at a rate of 4% in 1686 (De Kock, 1924), the present duty payable under the Transfer Duty Act of 1949 is only 3% for individuals (R30 000+) and 5% for companies. As a result the revenue raised from this source has been negligible.

The same may be said of property tax. Although providing the backbone of revenue requirements for local authorities, Central government has never utilised this tax as part of its revenue apparatus. Indeed, in a scathing attack on the high level of tax in South Africa, Wassenaar (1977:105 my emphasis) specifically excluded property tax from his list arguing that it has probably been 'the most neglected form of taxation in the RSA'.

A last example relates to capital gains tax. Although an integral feature of the Franzsen Commission's recommendations,

taxation in this form has never been part of the system, despite the loophole its absence has created for tax free accumulation of wealth. The Commission itself pointed out that:

" If capital gains are not also taxed, the system would permit a continuation of the present situation under which investors can increase their wealth through untaxed capital appreciation..."
(Franzsen Commission, First report, p.54).

As stated earlier, the absence of a capital gains tax together with a reluctance on the part of the State to enforce UPT provides considerable scope for the avoidance of tax liability via the medium of private, public and close corporations.

To conclude: consistent with the marxist approach, the absence of a number of wealth taxes, the very mild enforcement of the existing taxes on wealth, and the absence of capital gains tax, clearly underlie the State's accomodative approach to this revenue source, at least to the extent that wealth is taxed directly.

Where the analysis partially falls down though is in the realisation that these taxes do not constitute the total tax levied on wealth, if in fact wealth can be defined at all. The value of an equity for example, is nothing more than the discounted value of the anticipated stream of income to which it is expected to give rise. Yet, these income flows remain subject to income tax and, if they are large enough, attract high rates of tax. These taxes on the future income streams accruing to financial assets are in reality taxes levied on the value of the asset itself. (This is why a tax on capital gains is in fact a double tax and a tax on capital itself). Higher taxes on income

streams associated with an asset in turn lower the present value of all expected returns lowering the market value of the asset. In addition, despite constant criticism from many quarters (e.g., Kantor, 1985), interest payments on savings, which are a large component of wealth, are still taxed, as are nominal capital gains arising out of transactions in capital assets regarded as income. In short, although direct taxes on wealth have clearly been underutilised in the tax system, their true contributions exceed that identified above.

5.3 Taxation of the Working Class

The second major tenet of the marxist approach holds that in capitalist economies the working class bears a disproportionate share of the tax bill. The tax system is perceived to be regressive, inequitable, and for the most part 'exploitative', especially when the working class have few political rights.

To test the validity of this assertion requires an investigation into the nature of taxation as it affects the working class (defined as wage-earners). This, together with an examination of the incidence of government expenditure benefits, can go part of the way to identifying the overall nature of the fiscal system.

In the case of South Africa, this process can be further simplified (without loss of generality) by restricting the analysis to identifying the nature of taxation's effects on the Black working class. Indeed, if Maubane (1984:4) is justified, then this is undoubtedly the correct approach since he claims that 'if anything at all, the tax laws have seen to it that

Blacks' stock of wealth has remained low'. Makgetla (1986:20) too states that as in all other colonised African countries, the tax system in South Africa has 'reinforced income inequality'.

As highlighted in Chapter Two, when the second phase of formal taxation of Blacks began (Glen Grey Act, 1894), its objectives were entirely different to those of the other taxes enforced at the time. Consisting mostly of labour taxes, this tax system was primarily designed to ensure an adequate supply of cheap and exploitable unskilled labour for the gold and diamond mines by forcing Blacks out of the rural areas. As Rhodes once remarked, these taxes were designed to 'remove them (i.e., Blacks) from the life of sloth and laziness (and) to teach them the dignity of labour' (cited in Nattrass, 1981:68).

At this stage, therefore, taxation of Blacks in rural areas was not only regressive in nature, but more importantly, a coercive means through which capital accumulation could be accelerated via cheap labour exploitation in the mining sector (Davies, 1979:56).

When revenue criteria also became important, the Native Taxation and Development Act of 1925 was passed (hereafter referred to as the 'Black Act'). This Act consolidated the Union's different tax laws, making all Black males liable for a general tax of one Pound per annum, as well as for a local tax of ten shillings for every hut owned by a Black occupant 'in the Native location of the Union'. The Act also specified the minimum age of the Black taxpayer at eighteen years of age, three years younger than the corresponding level for White taxpayers who were eligible for tax under the Income Tax Act (No.40) of 1925 (hereafter referred to as the 'White Act').

Discrepancies between the White and Black Acts extended further than this. Unlike the White Act, the Black Act did not contain any abatements, rebates, exemptions, family size allowances, deductions for dependants etc., all of which were afforded to White income taxpayers. The same Act was also silent on the question of the minimum means of livelihood which rendered individuals liable for taxation. The age discrepancy itself had severe inequitable implications since in terms of the law eighteen year olds were still technically minors. As a result, unless they found work, the burden of the bill passed on to fathers, a feature which did not have a parallel in the corresponding White Act.

De Kiewiet (1941:199) notes further inequalities. Citing statistics from taxation in the early 'thirties, he notes that in the Cape Province, for example, a White could be in a position of not being liable for any income tax despite owning thousands of acres of land, whilst at the same time Blacks paid taxes for simply owning a hut in a reserve.

Thus, from the very start, the tax system as applied to Blacks was inequitable in many respects, Blacks being liable for tax at income levels which, under the corresponding White Act, would have remained entirely tax-free. As the Opposition Minister of Finance described it some years later:

"...in regard to the regressive taxes on natives. We tax them directly on everything they eat, drink, wear and use for shelter. In addition we impose on them a poll tax. That tax is a feudal anomaly.....it is inequitable as between natives and other race groups many of whom are earning the same wages as natives and are exempt from taxation altogether."
(Hansard, 1947, Vol.60, c.686, emphasis added).

This latter aspect is partly borne out in statistics of taxpayers covering this early period. In the 1929-30 tax year for example, there were only 66,699 White income taxpayers, whilst at the same time, there were 1,184,241 Black taxpayers, the bulk of whom would not have been liable for tax under the 1925 White Act provisions (Xuma, 1933).

Furthermore, unlike the White Act, the provisions of the Black Act were also very strongly enforced. 'Round ups' and 'Poll Tax raids' were regularly conducted and Blacks (other than the few exempted) were required by law to produce evidence of their latest tax payment in order to avoid further fines and/or jail. In 1930 alone, no less than 49,772 Blacks were convicted for various tax offences (Xuma, 1933:159).

The inequity of the tax system also extended to the allocation of State resources. Under the Black Act, one fifth of the general tax was paid into the Native Development Fund, which together with a fixed statutory grant comprised the finance earmarked for Black education. Thus, unlike White education which was financed on a per capita basis, Black education laboured heavily under a shortage of funds as a direct result of the provisions contained in this Act (see Chapter 2).

Despite considerable criticism from many quarters (for example SAIRR, 1933), the provisions relating to Black taxation remained basically unchanged for thirty three years, before, in 1958, tax rates were again raised. Corresponding with the period to which Lipton (1985:22) refers to as the 'Consolidation of Apartheid',

the poll tax for adult males was increased by 15%, and a graduated income tax scale was introduced, the rising cost of education cited by government as the reason for this move (p.95).

Admittedly, the provisions relating to the taxation of Whites had also changed markedly over this period. Yet, the changes brought about by the new dispensation still did nothing to ensure equity in tax rates across race groups.

The nature of the discrepancies was well highlighted in a 1958 SAIRR Report, which criticized the proposed increase in Black taxation on equity grounds. In their own words:

" So far as people in the lowest income groups are concerned, the proposed rate of general taxation for African men is higher than is the rate of personal taxation payable anywhere in the Union except for unmarried persons in Natal, for whom the rate is the same. In all income ranges, up to £450 a year, African men whether married or single, will pay more than married men of other racial groups in personal tax in all provinces except the Orange Free State."
(SAIRR, 1958, p.1, emphasis added).

The Report further highlighted the fact that Blacks were taxed for eight years more of their lives than other racial groups, that the same rate applied to both single and married persons, and that in general the Black population was liable for a variety of taxes which were not payable by Whites. The latter included local taxes, general & tribal levies, education taxes, and so on.

Despite these objections, the 1958 provisions were passed with the minimum of delay. A decade later, discrimination in taxation matters was further entrenched with the passing of the Black Tax Act of 1969. Although lowering the poll tax from R3.50 to

R2.50, the degree of progression of the income tax was again raised quite considerably.

Taxable Income R	TAX PAYABLE (R)					
	Blacks (All)	White, Coloured, Asian				
		Single	Married	One Children	Two	Three
250	2-50	-	-	-	-	-
500	5-26	-	-	-	-	-
1000	12-40	39	-	-	-	-
1500	22-42	99	32	-	-	-
2000	37-61	193	76	36	-	-
2500	57-61	267	125	81	41	-
3000	87-122	344	213	130	86	36
3500	127-221	425	274	220	135	81
6000	399-422	988	652	585	517	435

Source: 1972 Income Tax Act (White, Coloured and Asian)
1969 Black Tax Act

TABLE 5.5 BLACK AND WHITE PERSONAL INCOME TAX BURDENS FOR THE TAX YEAR 1973.

Table 5.5 (above) presents a comparison of Black and White individual income tax liabilities under the respective Acts for the 1973 tax year (post-Franzsen).

From Table 5.5, the degree to which discrimination was applied according to race is clearly evident. For persons in the lowest income groups (in which the majority of working class Blacks could be found), the rate of tax payable by Blacks was higher than those applied for all other races, except for single White males earning above R1 000 and married persons above R1 500. On the other hand, the pattern was opposite for all incomes over R6 000 per annum, which quite obviously did not apply to many Black earners.

The 1969 Act followed the earlier tradition of not distinguishing between married and unmarried individuals. Nor did it have relief for children, dependents, aged, life insurance, medical expenses or rebates, all of which served to reduce substantially taxable incomes for White income taxpayers.

Like the 1925 Act, the provisions relating to the 1969 Act were again strongly enforced. Authorized persons were granted powers to demand proof of payment and Blacks who failed to produce the necessary tax receipts could be charged. Estimates show that for the period July 1970 to June 1971 alone, in excess of 105,576 Blacks were prosecuted for tax law infringements (Horrel, 1973 :62). On the other hand, no White individual has ever been jailed in S. Africa for a tax offence unless related to fraud.

This of course changed in 1984. As discussed in Chapter 3, rising collection costs and hence a move to incorporate the private sector in the task of tax collections, general egalitarian considerations, and post 1976 'reforms' finally resulted in the scrapping of the separate Black Tax Act, and the inclusion of Blacks into the general Income Tax Act of 1962 (see Schalkwyk, 1984). The fact that up to 80% of all Black taxpayers (McGlashan, 1984:134) immediately became liable for less tax, even after the preliminary changes highlighted the regressive nature of all previous tax legislation, especially that preceding 1980.

A number of studies has also concluded that, in regard to the tax system as a whole, Blacks have throughout the post-war period been subject to relatively higher tax burdens. This is generally ascribed to the effects of indirect taxes on the overall regressivity of the tax system.

The most recent, and certainly the most authoritative of these studies is associated with the work of Michael McGrath (1979).

A seminal work in this area, McGrath attempted to 'arrive at a broader measure of racial incomes' by constructing a series of racial Budgets for the 1949/50, 1959/60, 1969/70, and 1975/76 tax years. Specifically, this entailed constructing a comparable historical record of changes in the distribution of government expenditure and taxation among the major racial groups.

In formulating this study McGrath encountered the major obstacle in the way of studies of this type i.e., the correct apportionment of the total tax burden among the various race groups. Briefly, since actual allocation depends upon the final incidence assumptions made about particular taxes (e.g., company tax), different assumptions automatically give rise to different estimated tax burdens. This in turn gives rise to different conclusions regarding the nature of the tax system.

Wilson's (1977;1979) remarks in regard to the South African situation are thus particularly relevant here. In his detailed examination of the issue he found that attempts to allocate State expenditure and revenue according to population group are 'fraught with both practical and conceptual difficulties'. He thus warns that 'it is difficult, and in many cases impossible' to quantify accurately the extent to which either Blacks or Whites can be said to have received or borne the costs and benefits of expenditure and taxation.

McGrath's solution to this problem (albeit partial), was to create a range of possibilities in which low, intermediate and high incidence assumptions were made regarding the range of taxes for which incidence theory was in doubt. Thus, income tax was assumed to be borne by the taxpayer, as were excise, sales taxes

and customs duties. On the other hand, the burden of company taxes, payroll taxes and property taxes were varied according to different assumptions. Whilst this did not eliminate the problem entirely, it did nevertheless offer a useful alternative matrix. McGrath's results are reproduced below:

	1949/50				1959/60				1969/70				1975/76			
	W	C	As	B	W	C	As	B	W	C	As	B	W	C	As	B
Taxes per cap. Personal Income	198	33	37	8	245	33	40	11	414	50	62	18	630	64	123	31
per cap. Taxes as a percent. of income	913	146	214	87	1111	175	194	94	1575	261	306	104	1934	333	432	155
	22	23	17	9	22	19	21	12	26	19	20	17	33	19	28	20

Source: McGrath, 1979: Table 7

TABLE 5.6 TAX BURDEN PER CAPITA (R), BY RACE GROUP, 1949/50 - 1975/76 (CONSTANT 1970 PRICES AND INTERMEDIATE ASSUMPTIONS)

From this Table (based on intermediate assumptions), it is clearly evident that although taxes as a percentage of income rose for Whites, Asians and Blacks over the whole period, taxes on Asian and Blacks (as a proportion of their per capita incomes) grew at a faster rate than per capita taxes on Whites. In short, whilst Whites paid, and continue to pay the vast bulk of the tax bill (~78%), the relative contribution of the Black groups has increased consistently since 1949, and at a rate faster than that of Whites. The measure of the real tax burden by per capita income presented in the Table reflects this differential growth, the Black share rising from 9% to 20% (1.2 times) and the White share rising less sharply from 22% to 33% (0.5 times).

Thus to sum up: relative to other comparable income groups, the Black working class can be said to have laboured under an inequitable, discriminatory and harshly enforced system of taxation. This is consistent with the marxist approach and true in regard

to both direct taxes on income (i.e., personal income tax) until 1984, as well as in regard to the tax system as a whole.

The extension of the analysis to argue that the Black working class was in any way 'exploited' by the tax system, at least to the extent that tax exploitation can be said to be consistent with an inequality between tax burdens and expenditure benefits, does, however require the incorporation of government expenditure.

In this regard, a number of studies have been undertaken, with the most useful contributions comprising the work of Leistner & van der Merwe (1967), Stadler & Leistner (1977), and McGrath (1979).

In the earliest study performed with any degree of sophistication, Leistner and van der Merwe allocated the taxes and expenditures relevant to Blacks over four selected years covering the period 1929 to 1964. All expenditures were allocated according to government accounts, and taxes were apportioned on the basis of incidence assessments derived from studies on Black expenditure patterns. A major drawback of this study, however, was the full allocation of company tax to Whites and not at all to Blacks, prejudicing the results (see McGrath, 1979:11).

Bearing this caveat in mind, Leistner and van der Merwe's conclusions still remain noteworthy. They found, as had all previous studies, that over the period 1929 to 1964, direct expenditure (nominal and real) on Blacks had grown at a faster rate than taxes paid by Blacks i.e., that the fiscal system was progressive and that Blacks had been net gainers from the budget.

Stadler and Leistner came to a similar conclusion about the overall progressivity of the fiscal system. Forming part of a little known project which attempted to investigate the relationship between government services provided for Blacks and taxes paid by them, the First Report concluded that:

"..expenditure in respect of Blacks in general and homelands in particular exceeds substantially the amount of taxes paid directly and indirectly by Blacks."
(Stadler, J. and Leistner, G., 1977, p.12).

The most authoritative study in this area is again McGrath's 1977 work. Although encountering similar allocating problems, McGrath constructed a similar set of matrices and found that even under the the most harsh incidence assumptions, the fiscal system throughout the period 1949 to 1976, contributed 'positively' to the economic welfare of Blacks. In his own words:

" Redistribution from government activity to Blacks and coloureds has been shown to occur in all years, even under the assumptions which produce minimum benefits."
(McGrath, M., 1979, p.34).

McGrath did, however, make the point that even under the assumptions that produced the maximum benefits for Blacks, White post-redistribution per capita incomes in 1975/76 were more than eight times Black post-redistribution per capita incomes. In other words, that the White community received more than 3,5 times more relative to its share of the population, whilst Blacks (at seventy per cent of the population) received only 30%. The effect of redistribution on per capita income has thus not been high.

To conclude: whilst there is ample evidence to support the

marxist assertion that the Black working class have laboured under a highly regressive and inequitable tax system, the evidence also confirms that with the inclusion of expenditure considerations, the fiscal system has actually been mostly redistributive and progressive toward the low income groups (even under the harshest incidence assumptions). As such (subject to the proviso highlighted above), the fiscal system has not been 'exploitative' as marxists would contend, but has instead contributed positively to the economic welfare of this group.

Since the completion of both of these studies, no further attempts have been undertaken to reassess the situation to take account of either the scrapping of the 1969 Black Tax Act or of the introduction of GST. Whilst the former undoubtedly reduced the relative burden experienced by the Black working class, the latter has acted in the opposite direction. Indeed, some marxist writers (e.g., Theron 1984:23) even go as far as to argue that since the introduction of GST has caused the low income groups to suffer most severely, its inclusion can best be described (in his words) as a 'type of class discrimination', aimed specifically at Blacks.

This last point is of course particularly relevant to the discussion when the net effect of both changes are considered in conjunction. That is, whilst the 1984 reforms were clearly beneficial to the Black working class, these gains were rapidly offset by the State's increased reliance on GST. Tax exploitation of the Black working class, at least to the extent that it can be said to be consistent with an inequality between tax burdens, can then simply be said to have changed its form

from being explicit in rates, to being more implicit in GST's regressivity. In other words, one form of tax inequality was substituted for another under the guise of reform. Moreover, consistent with the fiscal illusion concept, this new form of taxation is also considerably less visible.

Yet, if one again considers expenditures, then the introduction of GST, although adding a regressive element to the tax system, cannot as yet be said to have changed the overall progressive nature of the tax system. At best, it could be argued that its inclusion has made the tax system less progressive, with the tax system still progressive overall. As Abedian's study aptly concludes:

" not only.....(have).....total Central government taxes.....become less progressive, but also indirect taxes have become more regressive as their incidence has been shifting from luxuries to necessities. Overall, however, the tax system remains progressive."

(Abedian, I., 1984, p.19, emphasis added).

5.4 Fiscal Crisis

The last major feature of the marxist approach dealt with in this chapter, briefly considers the issue of fiscal crisis. To recap: according to this hypothesis, a fiscal crisis emerges in capitalist economies when the rate of growth in State expenditures relative to revenue capacity is of sufficient magnitude to produce such symptoms as; increased reliance on deficit financing and debt, increased tax resistance, strong and organised tax lobbies for lower taxes, high inflation rates and increased privatization. Some marxist writers (e.g., O'Connor, 1973) even go as far as to claim that, if severe enough, a

combination of these factors could ultimately result in the collapse of the State itself.

Similar arguments have in turn been put forward as being relevant to the current crisis in South Africa. Van Holdt, for example, hints at support of this view:

"The State.....is mired down in a financial crisis. Its expenditure has risen rapidly... (and).....although total revenue has also increased as government has scraped the barrel for more tax, it has not done so at the same rate. The result:ever increasing government debt, fuelling the fires of inflation."

(Van Holdt, K., 1986, p.308).

Despite these claims, however, close examination of the symptoms most likely to correspond with the notion of fiscal crisis do not yield much evidence to support this view.

Focussing on the trend of Budget deficits first, Table 5.7 below reveals that the Central Government's budget deficit has

PERIOD	DEFICIT AS A % OF GDP	DEFICIT AS A % OF EXP	PUBLIC DEBT AS A % GDP
1956-1958	3.6	19.9	44.8
1959-1961	1.6	9.9	45.8
1962-1964	1.9	11.2	42.1
1965-1967	3.3	17.0	39.3
1968-1970	3.1	15.4	40.6
1971-1973	3.7	16.2	37.3
1974-1976	5.1	20.7	31.8
1977-1979	5.0	20.4	34.6
1980-1982	2.6	11.3	30.5
1983-1985	4.1	15.6	34.2

Source: SARB; Quarterly Bulletins

TABLE 5.7 THE EXCHEQUER DEFICIT MEASURED AS A % OF GDP AND EXCHEQUER ISSUES, AND TOTAL PUBLIC DEBT AS A % OF GDP, IN THREE YEARLY AVERAGES, 1956 - 1985.

throughout the period (1956-1985) remained relatively low by international standards, averaging only 3.4% of GDP. This was

especially the case over the periods 1959 to 1964 and 1980 to 1982, during which time the budget deficit amounted to a mere 1.7 and 2.6% of GDP respectively, hardly indicative of either a current or impending fiscal crisis.

The only possible exception to this pattern of conservative budget policy, lay over the period 1970 to 1979. Here, partly as a result of increased expenditure following heightened political unrest (post 1976), and partly due to the use of Keynesian-type remedies during periods of prolonged economic recession, the size of the budget deficit rose from its post-war average of approximately 3.4% to levels exceeding 5.6% of GDP. This was reflected in a rise in the share of expenditures financed out of non-current revenue. Averaging around 14% of total expenditures in the 'sixties, the budget deficit measured in these terms rose to around 20% in the 'seventies, indicating a definite reluctance on the part of the State to resort to increased taxation to finance larger expenditure requirements. What is more, over this same period, the bulk of the financing needed for these deficits was obtained from bank credit and foreign borrowing, a sure sign that the once conservative approach to budgeting had been partially compromised. As one source described it:

" During the 1970s the tight fiscal control of the two previous decades was lost. Between 1970 and 1979 budget deficits averaged 5.3% of GDP with a peak of 6.8% in 1975. Moreover, until the tough and conservative budget of 1976, on average nearly 40% of those large deficits were financed by a combination of bank credit and foreign borrowing."
(Nedbank, Economic Review, 1983, p.186, my emphasis).

The distinct lack of budgetary control over this period was also

identified and severely criticized by Wassenaar (1977). Commenting on the massive increase in State expenditures over this period, Wassenaar argued that the State had 'overspent' itself to the point where it was locked in a 'financial dilemma'. Although not making any mention of fiscal crisis per se, Wassenaar was nevertheless concerned with how these expenditures were to be financed from existing revenue sources.

Although careful examination of 1970's data supports Wassenaar's claim of some fiscal 'irresponsibility', it provides no real evidence that the State over this period was experiencing anything near a fiscal crisis. As Kantor (1977) quite correctly argues, Wassenaar's fears of a 'financial crisis' were definitely 'exaggerated'. And, with beneficial hindsight, one has to agree.

The State's conservative approach to deficits naturally extends to its management of Public debt. Table 5.7 reveals that the real stock of debt (debt/GDP) has not only been small by international standards, but it has fallen from levels of 46% in the 'forties and 'fifties, to 32% in the 'eighties. And, although the interest payments servicing this debt have risen from 256.6m (1970) to R1154.7m (1984) in only fifteen years, this reliance on deferred taxation cannot be said to be either excessive or a threat to the financial stability of the State (see Abedian, 1984b:16). On the contrary, deficit policy over the last decade (partly as a result of fairly strict conformity to the IMF's arbitrary 3% deficit rule), suggests that if anything, budget policy has been mostly restrictive (see Rees, 1986).

It is also important to note that with the possible exception of

part of the period discussed above, deficits in the post-1976 phase remained relatively small, despite budgetary initiatives introduced in 1976 which literally opened the way for increased deficit spending and public debt.

Prior to 1976, the dual budgetary system of the government, virtually ensured that current expenditure was financed from current revenue, and capital expenditure from loans. This arrangement essentially guaranteed a degree of financial discipline. Government expenditure growth could not be directly controlled, but at least the necessity of having to finance it through current revenue was a limiting constraint.

The adoption of the Unitary Budgetary System in 1976 changed this picture entirely. Under the new system, government expenditure (both capital and current) is funded directly out of one account, the State Revenue Fund. The deficit is determined not by the size of the capital outlays, but simply by the difference between total expenditure and total revenue. Not only does this mean that current expenditure can now theoretically be financed out of loans, but the borrowing powers of the State (controlled prior to 1976 under the old arrangements), are now 'virtually unlimited' (Van der S. Heyns, 1982).

Table 5.7 above shows that the State has essentially ignored this option and has remained very conservative in its management of budget deficits and debt. This is despite the fact that increased deficits have definitely 'contributed to total public spending in real terms' (Tremidas, 1985:414).

These conclusions on the subject of fiscal crisis are unaffected

when cognizance is taken of increased taxes and new tax adoptions. There has been a long history of calls for reduced taxation from many quarters, a fairly well organised tax lobby in favour of lower taxes, and discontent with a number of aspects of the tax system (e.g., 'joint' taxation, GST on food, Fringe Benefits etc.). Despite this, the State's fiscal policy has never really been seriously challenged to the point where additional tax charges have had to be put off or delayed for any period of time. Nor, as Simkins (1984:15) argues, has there ever been any 'overt political struggle about the lines of budgetary policy' or sufficient organization of the working class.

To conclude: despite periods of possible fiscal irresponsibility, public dissatisfaction with aspects of the tax system, and growing constraints on revenue sources, the State, to date, has not approached a financial crisis of significant proportions, much less of the magnitude severe enough to be consistent with the marxist notion of fiscal crisis. Nor is this entirely unexpected given South Africa's stage of capitalist development.

As Simkins concludes:

" Despite the presence of a number of symptoms - an inflation rate currently high by international standards, a well organised and articulate lobby in favour of low taxes and limited government, a not very impressive growth record in recent years - the answer....(i.e., on whether the State is in the midst of a fiscal crisis)...must be no." (Simkins, C., 1984, p.15).

5.5 Conclusions

Although the marxist approach to tax structure change is comparatively undeveloped in the literature, the insight provided

by it is immense. This is clearly borne out by the significant contribution this approach makes towards understanding the development of the S. African tax structure.

Firstly, given the low 'real' tax rate experienced by the corporate sector, the few direct taxes on wealth, and the considerable number of measures available for subsidized automation and mechanization, the tax system can, in a number of respects, be said to reflect the interests of the capitalist class, at least insofar as these benefits can be said to have favoured this class of taxpayers exclusively. The only exception to this is in the taxation of the mining sector which has paid and continues to pay a disproportionate share of the tax bill as a result of its role as provider of surplus for sectoral redistribution.

Secondly, the Black working class can be said to have laboured under an inequitable and regressive system of taxation until 1984. However, the inclusion of expenditure considerations provides clear evidence that this same class of taxpayers cannot in any way be said to have been exploited by the fiscal system as a whole. On the contrary they can be said to have benefitted favourably from it.

Lastly, despite periods of increased deficit spending, a relatively high inflation rate and an organised tax lobby against higher taxes, the South African State cannot be said to have ever experienced any form of budgetary crisis, much less a crisis of the magnitude consistent with the marxist notion of fiscal crisis.

SUMMARY AND CONCLUSIONS

The evolution of the South African tax structure over the period 1946 to 1985 can be ascribed to a complicated mix of economic, political and social factors.

Economic development, in particular, has played a crucial role (see Chapter 3). Not only has it provided the tax bases and tax 'handles' necessary to ensure the adequate financing of revenue requirements, but it has also clearly influenced the size and composition of revenue collections. In a number of respects, it has also played a crucial role in determining the direction, pace and scope of tax reform.

Possibly the most significant aspect of the tax structure affected by economic development has been the tax ratio. This has increased markedly in size over the whole period concerned, with much of this growth directly attributable to the expansion in taxable capacity. Moreover, consistent with international studies, this growth in taxable capacity is itself partially explained by variations in; per capita income, the sectoral composition of GDP, and to a lesser extent the degree of 'openness' of the economy.

Economic development has also played a significant role in affecting the composition of this revenue in two main ways:-

Firstly, on a direct level, economic development has had a differential influence on the behaviour of the various base to income elasticities of the major tax sources, and, therefore, on

their relative revenue contributions. Customs and excise duties, for example, dominant forms of finance in the post-war period, presently contribute relatively little to revenue as a result of their low base to income elasticities. To a large extent this was also true of the indirect tax share as a whole up until 1978 (i.e., pre-GST). On the other hand, personal income tax, and to a lesser extent, company tax have continued to grow at a relatively faster rate. Barring the incorporation of additional indirect tax sources, this trend can be expected to continue in the future.

Secondly, on an indirect level, economic development has provided a number of additional tax bases, the incorporation of some of which has manifested in a change in the revenue mix. Discretionary action, partly as a response to an increase in the demand for government expenditure, and partly a result of the need to cut rates and broaden the overall tax base, led to the introduction of sales duty in 1971, and GST in 1978, both of which have altered the relative contribution of the various revenue sources.

Like other developing countries progressing through similar stages of economic development, the tax collection process has also become considerably more centralised. The rights of the provincial authorities to levy company tax were withdrawn in 1957, and the same applied to individual income tax in 1971. As a result, not only has the tax system become more efficient from a tax collection point of view, but the scope for increased redistribution across provinces via the budget has been extended significantly.

Without doubt though, the greatest efficiency gains have resulted from the 'farming out' of the tax collection process to the private sector. Careful reading of the history of S.African tax policy evolution reveals that a number of major tax initiatives (e.g., the scrapping of the private company apportionment system, PAYE, the scrapping of the 1969 Black Tax Act, and the final PAYE deduction scheme) were introduced with the expected reduction in the costs of collection a major attraction. One consequence of this is that private sector firms are currently in the forefront of the tax collection process relieving government of considerable financial cost, and, in the case of Black taxation, immense political antagonism.

It is important to note, however, that whilst economic development has been instrumental in enabling the tax system to expand and mature, South Africa has not yet progressed to the stage where tax authorities can be said to have available to them the full range of tax policy options commonly used overseas. That is to say, whilst forty years of economic development has certainly brought with it increased flexibility, additional tax sources and a lower degree of tax 'effort', tax policy in South Africa still finds itself confronted by a number of constraints generally associated with tax policy in developing countries. These more than anything else, serve to limit to a minimum the range of tax policy options available to policy planners. Since 1970, this has not been so much in regard to the availability of tax instruments, but more in terms of the efficient utilization and management of existing tax sources, especially personal income tax.

A small but declining number of tax instruments commonly used overseas still remains out of reach too. A Value Added Tax, for example, might still be too complicated a tax to introduce successfully into S. Africa given the country's level of business sophistication. Similarly, a flat rate individual income tax, ostensibly a target of current US tax policy, cannot be considered as a realistic option for S. Africa given its present distribution of taxable income and pressing expenditure requirements.

After economic development, it has been political factors which have had the greatest effect on tax policy evolution (Chapter 4). In a more general sense this thesis shows that whilst economic development has produced the tax bases and 'handles', it has been decisions taken in the political sphere which have ultimately determined which tax bases have actually been used, and certainly which more or less than others.

This latter assertion is borne out in an examination of the factors surrounding the management of the individual income tax base. Consistent with the public choice approach, the distribution of this burden clearly reflects vote-maximizing behaviour. Few taxpayers/voters have paid the bulk of the tax bill, whilst the majority have paid (and continue to pay) relatively little. At least up until 1978, this policy of vote-maximization also corresponded with a policy of low tax rates for the Afrikaner majority, at the expense of the numerically less-influential English-speaking high-income minority. Similarly, until recently, the farming community has received a preferential tax policy due to their disproportionate role in the electoral numbers game.

This vote maximizing approach to the taxation process is again evident in the timing of tax announcements. A crucial variable in tax policy, the history of tax announcements displays a predictable path strongly consistent with the electoral tax cycle hypothesis. Tax increases, especially those concerning personal income tax, excise and sales duties, have generally come after elections and tax concessions before. The budget too has remained sensitive to the electoral cycle with the bulk of 'tough' budgets coming after elections and 'relief' budgets coming before.

To a lesser extent, this vote-maximizing approach to tax policy has also extended to the choice of tax instruments. As proponents of the fiscal illusion hypothesis would argue, S. African taxing authorities, intentionally or otherwise, can be said to have utilised tax instruments and methods of collection which have served to minimize the subjective burden of the tax system. According to this view, innovations including sales duty, GST, PAYE, can all be regarded as possible manifestations of government's attempts to reduce the subjective burden of the tax system. Government's refusal to index the personal income tax system, in particular, is another powerful example of this, since this 'neglect' has enabled effective rates and revenues to rise quickly, yet surreptitiously, obviating the need for formal legislative action.

In a way similar to economic constraints, government's vote-maximizing tax policy has served to shorten further the list of tax policy options. Income tax reform, in particular, will

remain crucially dependent on the degree to which government is willing to tax the low-income groups directly. Similarly a full-blown estate duty, land taxes and realistic taxation of the agricultural sector will remain excluded from the tax apparatus as long as rural constituencies maintain a disproportionate influence on the legislature. In a much broader sense, powerful interest groups, such as hoteliers, exporters, breweries and certain privileged traders and inefficient domestic producers, all of whom receive preferential tax concessions, restrict the full exploitation of a number of other viable tax sources. Needless to say, a host of other potential tax sources (e.g., a Consumption tax), stands little chance of ever being used since their implementation would require a drastic overhaul of the tax system, an ordeal risk-averse vote-maximizing politicians will clearly want to avoid.

In addition to those political influences which can be said to have their origins in voter and political party preference, the development of the S.African tax structure also reflects the country's underlying class structure (Chapter 5).

The capitalist class, insofar as they can be said to comprise property owners and holders of corporate stock, have throughout the period concerned received a tax policy mostly reflective of their needs. This beneficial policy has included; a low effective corporate and UPT tax rate, few direct taxes on wealth and the absence of a capital gains tax. The tax system has also been accommodative with regard to providing measures for enabling increased automation and mechanization through the system of capital incentive allowances. Not only has this resulted in

increased capital intensification throughout all sectors, but the effect of these fiscal allowances has been to exacerbate the disparity between the statutory and 'real' company tax rate and thus the corporate sector's revenue contribution.

The only possible exception to this preferential tax policy has been the taxation of the mining sector. Unlike non-mining companies they have since the 'thirties been subject to a relatively higher tax burden, contrary to the marxist prediction. This same discriminatory taxation, is, however, not inconsistent with the marxist capital fraction argument, which correctly identifies the mining sector as the source from which profitable accumulation in other sectors has been financed.

Whilst the capitalist class can be said to have enjoyed a relatively beneficial tax policy, the working class, but more specifically the Black working class, has not. Consistent with the marxist analysis, they can be said to have been subject to a highly inequitable and regressive form of taxation, in regard to personal income tax until 1984, as well as in regard to the tax system as a whole. To some extent, this has continued to be the case with the trend toward increased reliance on GST fully offsetting the concessions brought about by the 1984 reforms. Tax exploitation, at least to the extent that it can be said to be consistent with tax inequality, can thus be said to have simply undergone a change in form.

Where the marxist analysis falls down though is with the inclusion of government expenditure. All authoritative studies

in this field reveal that even under the most harsh incidence assumptions, the tax system has remained predominantly progressive, with the working class a net gainer from the budget. In this sense, and subject to the extent to which tax exploitation can be said to be consistent with an inequality between tax burdens and expenditure benefits, one could say that this class of taxpayers has not been exploited by the State. The assumed direction of redistribution in the marxist schema would thus appear to have little to offer in regard to explaining the direction of redistribution locally.

One other aspect in which the marxist analysis has little to offer by way of interpreting the South African experience is in the area of fiscal crisis. Despite the presence of a number of symptoms (i.e., a relatively high inflation rate, and organized tax lobby for lower taxes, periods of increased deficit spending and increased privatization), as well as periods of some fiscal irresponsibility (e.g., middle 'seventies), it is clear that S. Africa has never experienced a financial crisis of any meaningful proportions, much less one severe enough to be consistent with the marxist notion of fiscal crisis. This is despite legislative innovations introduced in 1976 which provided mechanisms for this to take place.

It is also clear from the evaluation of these three perspectives (the conclusions from which are summarised above) that in a number of areas there exists considerable differences of opinion. In addition, as discussed throughout the text, in almost all cases these interpretations have been at variance with the official view forwarded by government at the time.

In possibly one or two instances, these differences in interpretation can be reconciled. In others, attempts at integration or synthesis remain problematic, especially in circumstances in which divergent accounts have their roots firmly entrenched in ideology (e.g., perceptions as to the nature and role of the State, the aims of tax policy and so on).

The 'correct' interpretation of GST, for example, is a case in point. Introduced in 1978, it ostensibly represented government attempts to lower income tax rates and to broaden the tax base through increased reliance on indirect tax.

Public choice theorists, however, would challenge this explanation. In terms of the fiscal illusion hypothesis, they argue that attempts to increase indirect tax at the expense of direct tax have little to do with tax equity and economic growth considerations, but rather reflect government's desire to reduce the visibility of the tax system. This they see as consistent with vote-maximizing policy, the minimization of subjective tax burdens being an important variable in the package of policies designed to achieve this end.

Economic development theorists would in turn refute this explanation. In terms of the structuralist model, they would argue that the base for GST, like the base for sales duty and other taxes, emerged 'automatically' during the course of economic development and was incorporated to ensure the adequate financing of growing expenditure requirements. Little suspicion is laid at the door of government in this regard since they see

tax policy in developing countries continually restricted to a few tax sources, the inclusion of additional ones coming only when the country has reached a stage of economic development which allows this to take place efficiently.

A third explanation would also be forthcoming from the radical school. Considerably more sceptical of the role of government (State) than are public choice theorists, they interpret any changes to the tax system in terms of the classical marxist labour capital dichotomy. GST, like sales duty and other indirect taxes, may be proportional in rates, but is regressive in effect. Its burden falls most heavily on the low-income groups and is thus a means through which the State and the capitalist class enforces tax exploitation of the working class.

The interpretation of abolition of the private company apportionment system is another innovation up for debate. Abolished in 1952, this move was paramount in changing the method of tax collection from private companies.

According to the economic development approach, this change was simply a measure aimed at reducing the cost of collecting tax from private companies. Echoing the official viewpoint, structuralists would argue that whilst other factors certainly played a role, efficiency in collection was the principle determinant behind this change.

In terms of the marxist model, however, the reason offered for the scrapping of the apportionment system is believed to be much more fundamental. Consistent with the marxist schema in which

the capitalist class receives a tax policy reflective of their needs, marxists would support the view that the apportionment system was abandoned because it was having a negative effect on company profits and capital formation. They offer similar reasons for the State's apparent reluctance to strongly enforce UPT, as evidenced in its low effective rate and negligible yield.

Similarly, the growth in the tax ratio, interpreted in Chapter 3 as a consequence of the full utilization of an expanding taxable capacity, carries little weight in the marxist schema. Rather, they interpret any such growth in 'value appropriation' as fully indicative of the rising cost of enforcing and maintaining capitalist rule and domination. To some extent the incorporation of additional taxes, especially those levied on the working class, are seen as the means through which this has been achieved.

Another innovation consistent with the cost of collection hypothesis but refuted, this time by public choice theorists, would be the PAYE rationalization in the early 'sixties. The latter would argue that whilst PAYE does represent a reduction in administrative costs, its primary goal is one of reducing the visibility of the tax system through monthly fragmentation of a yearly tax bill. To an extent this is evidenced in the high average tax rates currently in force today, the level of which could not be maintained (or reached!) under a system of yearly assessment. Tax concealment, and not cost of collection considerations, would also be forwarded in regard to the incorporation of the PAYE final deduction scheme.

At least three plausible explanations exist for the scrapping of

the 1969 Black Tax Act as well. A first view, and one which cannot be rejected out of hand, relies on the official government's stance that purely egalitarian motives were involved. A second view would stress gains to be made from lowering the cost of collections and minimizing political antagonism, through co-opting the private sector into the tax collection process. A third view, that of the radical school, would reject both these and would interpret deracialization in taxation as a subtle change in the form of taxation through a conversion of explicit tax exploitation of the working class via personal income tax to covert tax exploitation via GST.

Evaluation of the the dominant theoretical perspectives also reveals that for some aspects of tax structure change there is agreement, albeit partial agreement, on the motive behind them.

One such area is in the marxist and public choice interpretations for the introduction of PAYE, the PAYE final deduction scheme, sales duty and GST. As stated above, public choice theorists would interpret all these moves as attempts by government to reduce the average voter's subjective tax bill. Marxists in turn would support this line of thinking, but at the same time would stress that the primary objective behind these moves, especially in the case of the PAYE Final deduction scheme, was the fragmentation and disaggregation of the working class's tax bill.

Special interest group predictions implicit in the public choice approach, and marxists class analysis have some common ground as well. Excessive taxation of the mining sector, for example, is plausible in terms of the marxist capital fraction argument.

The same discriminatory taxation is, however, also consistent with the special interest group view that the mining sector lacks the political clout to obtain a tax policy fully reflective of their needs. Similar arguments can be developed in terms of both of these approaches to account for the absence of taxes on wealth, the lenient tax treatment of the farming sector, differential tax rates in the producing sector and so on.

To sum up: almost all aspects of tax structure change over the period 1946 to 1985 can be either fully or partially explained within the framework of at least one or more of the three theoretical approaches evaluated in this thesis. What is more, in some areas (e.g., changing composition of collections), there appears to be only one possible explanation, whilst in others the issues are far from clear-cut, debatable and characterised by bitterly contested divisions.

Most importantly though, whilst the evaluated views together account for almost all aspects of tax structure evolution, none of these approaches on its own is able to explain all changes, or indeed give a full and complete account for any one change. Nor, with few exceptions, are any of the opposing arguments sufficiently powerful enough to wholly reject any of the other explanations in respect of tax innovations for which there are two or more interpretations. To identify categorically one approach as the so-called 'best' approach is, therefore, impossible to do given the multitude of factors involved.

One possible means through which these differing contributions can be accommodated however, is through the reliance on a

eclectic exposition which incorporates the relevant contributions of each. Such a framework would consolidate not only the ideas of each of the core theoretical perspectives already discussed, but also the insights provided by other views, not directly accommodated in any of the above.

One such contribution would comprise Kaufmann and Larkey's hypothesis discussed in the introduction to this thesis. Although having little to offer by way of interpreting major tax initiatives in S. Africa, many short-term minor innovations remain explainable in just these terms. Indeed, in a number of instances, their inclusion is evidenced in the complexity of the tax system itself, with the associated costs invariably emerging in the steps taken to rectify them in the mini-budget and budgets following their incorporation.

One particularly good example of this relates to the full range of tax measures introduced specifically with the aim of reducing tax evasion and avoidance. In addition to specific tax instruments (e.g., the apportionment system, UPT, and Fringe Benefits tax), literally thousands of tax amendments have been passed over the years with the sole aim of closing tax loopholes that have emerged over time. Unfortunately, the cumulative effect of policies designed to convert last years tax avoidance into this years tax evasion has been little more than to complicate the tax system. Today a whole profession of tax consultants devotes immeasurable productive energies to finding and exploiting undiscovered tax loopholes. This in turn provokes further ad hoc amendments and legislation complicating the system more.

Just as Kaufmann and Larkey's view cannot be wholly rejected, nor can the official explanation, as forwarded by government at the time, always be rejected either. Indeed, a less sceptical view might fully exonerate government from most of the accusations levelled against it in regard to fiscal illusion, tax 'farming', vote-maximization and tax exploitation. These same proponents of the view that government and politicians operate without self-interest in pursuit of the common good would further argue that tax policy emerges out of a general desire to maintain among other; vertical and horizontal equity, tax certainty, efficiency and economic growth.

However, whilst this view might successfully account for some aspects of tax structure change, such a scenario does not account for the evolution of the S.African tax structure. At best, it might partially account for some of the recommendations and proposals which have emerged out of Commissions and Committees in which these fundamental guidelines have been observed. But, this same advice has not necessarily been followed by government. The major contention of this thesis, therefore, is that major tax innovations and policy realignments have not emerged out of a pursuit for tax equity, or out of yearly problem solving decision-making processes. Rather, the multitude of tax changes which comprise the evolution of the S.African tax structure has come about as a result of specific developments in the economic, political and social sphere, explained in terms of theories presented here.

At some time during 1987, the South African tax system will

undoubtedly be modified according to the recommendations of the Margo Commission on taxation (as yet unpublished). This Commission, like all previous Commissions in South Africa will have been faced with the seemingly insurmountable task of reforming the tax structure within the framework of broadly defined terms of reference. It is also quite likely that in some areas this will have been achieved. In the final analysis, however, it will be a much more restrictive set of factors, many of which have been discussed here, which will ultimately determine the nature of proposals made, be it in the planning, proposal or implementation stage.

For this reason it is hoped that from the outset the Commission will endeavour to have done little to accommodate this. It is thus hoped that the Commission will have taken the stance that real tax reform means much more than a reallocation of tax bills, and certainly more than a consolidation of tax changes that have come since Franzsen. To avoid further manipulation in the political sphere, the Commission will also have to have taken reform to mean more than attempting to accommodate the full range of demands for tax cuts emanating from various interest groups. Most importantly though, real tax reform will have to have meant a complete rethink of ideas concerning tax burden and tax incidence, through increased appreciation of theoretical and empirical contributions which have put paid to old-established views on taxation.

The whole task facing the Commission can of course be made much easier if its efforts remain solely geared toward reforming the tax structure in the interests of economic growth (see Kantor,

1985). This involves not only a concerted effort to simplify the tax system, but also the implementation of tax instruments and the scheduling of tax rates so as to minimize their disruptive effects on the private economy. This is the essence of true tax reform.

By far the most valuable contribution that the Commission can make, however, is through providing the conditions necessary for encouraging economic growth through measures designed to stimulate domestic savings. This would involve among other; the abolition of taxes on returns from saving (in whatever form), tax neutrality in all spheres, and most importantly a move toward expenditure rather than income as the basis for taxation. Without this, and, therefore, without economic development and concomitant political stability, the most that domestic tax reform will be able to achieve is the rearrangement and renaming of existing tax instruments around the same small group of taxpayers who ultimately comprise the source of South Africa's limited taxable capacity.

FOOTNOTES

Introduction

1. Ambiguously defined in the literature. For the purposes of this thesis, the term 'tax structure' is broadly defined to include; the size of the tax ratio, the composition of revenue collections, the tax instruments used, the schedule of tax rates applied, the methods of collection used, and the degree of centralization of revenue collections (See Alt, 1983).
2. See also: Kahn (1946), Houghton (1947), Jones (1953), Holloway (1954), Simpson (1968), Sadie (1969), Botha (1969), Trotter (1969), Van Waasdijk (1969), Strydom (1971), Browne (1974;1984), Franszen (1978;1984), Posel (1982), Theron (1984), McGlashan (1984), Trimidas (1985), Kantor (1986b).
3. On the other hand, government expenditure trends have been fairly well examined. See: Richards (1957), Van Waasdijk (1964), Steenkamp and van Dyk (1974), Seeber and Dockel (1978), Abedian and Standish (1984), Abedian (1984b), Trimidas (1985).
4. As a Minister of Finance once remarked:

" It would be a mistake to regard the budget as merely a patchwork of ad-hoc measures designed to meet particular problems."
(Hansard, 1970, Vol.32, c.1550).
5. It is not of course intended to suggest that government has followed a consistent tax policy over the whole period. Indeed, ad hoc decisions have been made and short-term goals have been pursued many of which have been at variance with one another. Rather, it is contended is that the South African experience remains unique in that the same government has been in power over the whole period under review. To a large extent, therefore, it is only realistic to expect that tax policy has reflected a philosophy roughly consistent with the government's objectives and ideology.
6. See Steenkamp and van Dyk (1974) for an informative statistical overview.

Chapter One

1. In fact only one attempt at a 'general theory'- Hinrichs (1966). But, Alt (1983), Musgrave (1969), Hinrichs (1966), Forte and Peacock (1981), Downs (1957) and O'Connor (1973) have between them discussed and highlighted almost all the major themes.
2. The tax base of a given tax is defined as the source from which its revenue is derived e.g., income is the tax base for income tax, property the tax base for property tax, imports the base for customs duty etc..
3. Tax 'handles' - Musgrave's (1969) term. Defined as a convenient base to which a tax rate can be applied e.g., general wages and salaries (see Musgrave and Musgrave, 1985:151).
4. See page 13.
5. Not given much attention in the literature in the context of this subject and, therefore, not discussed separately.
6. It also 'appears' to apply to South Africa (Abedian and Standish 1984, Seeber and Dockel, 1978).
7. Hence his 'law' is in fact tied up with his normative assumptions as to the nature of the State (Bird, 1974:3).
8. Therefore, for a developing country that lies somewhere between these two extremes, it becomes a 'moot point' as to whether it is political or economic factors which play the dominant role (Mansfield, 1971).
9. A positive public choice approach i.e., one which views government as a separate and distinct entity operating in the market trying to maximize its own utility, is unlike earlier quasi-orthodox approaches developed by Buchanan (1967) and Buchanan and Tullock (1962). In these works, government is viewed as an efficient benevolent agent acting without self-interest, emerging out of the collective decisions of individuals to produce the so-called market failures. Simply, government is a frictionless mindless process which allows consumers to undertake decisions collectively rather than individually in order to maximize their utility. Yet, if this were the case, there would not be a reason for positive analysis (see Pommerehne and Schneider, 1983).

10. The 1984 American Presidential elections, in which taxation was a major factor in voters decisions, is a fairly realistic example of this. As Time Magazine notes:

" One of Mondale's first moves was to level with voters and tell them that if elected, he would raise taxes to cut the deficit. This candor cost him. About a quarter of voters cited the potential of a tax increase as their reason for voting against Mondale."
(Time magazine, 1984, Nov., p.45).

11. A good example of this is the size of the tax ratio:

".....the division of resources between the public and private sectors is roughly determined by the desires of the electorate."
(Downs, A., 1960, p.541).

12. Special interest group participation can also be analysed in a framework of what economists call rent-seeking (see Tollinson, 1982).
13. In fact Karl Marx paid very little attention to public finance issues, except for a small contribution on the role of debt in capital accumulation.
14. This study of 'fiscal sociology' is also the last (Musgrave, 1980).

Chapter Two

1. Generally speaking, in South Africa, major policy innovations arise out of recommendations and proposals made by various official bodies appointed by government. Usually given fairly wide terms of reference, these bodies take both private and public representation into account in the formulation of their proposals. The government in turn, can then either accept or reject any or all of them. Minor changes on the other hand are mostly made yearly on an ad-hoc basis at budget time. These decisions are usually made independently by the Minister of Finance, after consultation with the Standing Commission on Taxation (post-1971), and other representative bodies.
2. Diamond Mining companies paid a relatively high rate of tax (22.5% in the Pound), as well as a duty on diamond exports.

3. In addition, gold mines were also entitled to a redemption allowance on all unredeemed capital expenditure, which could be spread over the estimated life of the mine. In later years, all capital expenditure became fully tax deductible.
4. The whole question of customs and excise duties policy, is in itself a highly involved field, the treatment of which cannot be adequately covered here.
5. It is also important to note that in accepting this approach to gold mining taxation, the government had also effectively rejected earlier recommendations contained in the 1945 Council Report. Examined at length in an appendix to the main report, the Council proved that the use of a formula tax, of the type proposed by Holloway, would lead to the mining of gold ore that in the absence of such a tax would ordinarily have been deemed unpayable. Thus, in direct contrast to the Holloway recommendation, the Council maintained that the scheme was inefficient, inequitable and clearly a waste of the country's resources. Instead, their recommendation was that mining taxation be 'brought into line with the tax on the incomes of other public companies' (S.E.P.C., 1945:35). This was also the view expressed by the Chamber of Mines which backed this view (see C.O.M., 1946). The government on the other hand has remained unwilling to relinquish this source of finance and has defended its policy of differential taxation ever since.
6. Although the Commission had been given fairly broad terms of reference, one notable omission was that of 'equity'. As a result, a number of non-equitable issues, such as Black taxation were left virtually untouched.
7. In July 1984, certain 'essential' or 'basic' commodities were excluded, and in 1985, the 'add on' system became compulsory.
8. Defining direct taxes is fraught with complications, since in the long-run one may argue that all taxes are indirect. For the purposes of this thesis, however, direct taxes comprise; company tax, individual income tax, gold mining taxation, other mining taxation, NRST, Interest and Dividends. Indirect taxes comprise; customs duty, excise duty, sales duty, GST, Stamp duties and Fees, and Transfer duty. 'Other' taxes comprise; gold mining leases, and estate duty (see classification in Department of Inland Revenue, Special issue, 1986, which covers the period 1966 to 1985).

Chapter Three

1. Mention should be made, however, of the role that social security contributions have on the size of revenue

collections in many Western democracies. If tax ratios are adjusted for these collections then the actual tax ratio is invariably much lower (for example, see Krogh, 1969; Heald, 1983).

2. Taking a somewhat broader view, O'Dowd (1977:28) maintains that South Africa has experienced a 'normal' pattern of development since its pre-take off stage (1866), with 'most' of its present day political and social characteristics consistent with the so-called 'second' stage of the Rostowian Growth Thesis. On the other hand, Houghton (1973:17) maintains that the South African economy has already experienced this second phase and has since 1945, been 'set to begin the drive to economic maturity'.
3. Testing the model in a shortened form:-

$$T/GDP = f(Ag, Pn, X+M/Y)$$

The following results were achieved:

CORRELATION MATRIX

(No of observations = 40)

	constant	Pn	Ag	X+M/Y
constant	1	.000	.000	.000
Pn	.000	1	-.9054	-.7805
Ag	.000	-.9054	1	+.7603
X+M/Y	.000	-.7803	+.7603	1

$$T/GDP = .027 - .055 Ag + .000157Pn - .00020 X+M/Y$$

(2.4) (-2.89) (3.64) (-3.76)

$\bar{R}^2 = .88$

Adjusted DW 2.03

The correlation above shows clearly the substantial multicollinearity which prevents straightforward interpretation of these results. Given this problem, the predictive power of the coefficients estimated through the regression procedure is naturally suspect, despite the high t-statistics obtained.

Worth mentioning too is that as a predictor of T/GDP, changes in all three variables simultaneously (especially if they continue to shift in line with current trends) would be quite effective as shown by the high R^2 , but the use of only one is suspect.

Possible ways out of this problem would include; Ridge regression, and use of principle components to get around the problem of multicollinearity. This is an area for future research.

4. Specifically, the use of single variable regressions does not eliminate the implicit problem of multicollinearity. Given

that there exists a strong correlation between the variables involved, the single variable regression does not strengthen the implied causality of the results. The analysis in fact founders on precisely the same rocks as did the multiple regression approach.

5. The causation may in fact be the other way around i.e., higher tax collections may have enabled government to undertake policies of a more redistributive nature. Thus Bromberger (1982:180) exhaustive review article notes that over the period 1961 to 1971 (corresponding with the growth in the tax ratio), the 'consistent regressive policies of the early years of the National Party began to be replaced with a less harsh approach'. The degree to which the factors affected the distribution of income itself must, therefore, also be taken into account.
6. Put formally, the elasticity of tax to base can be measured by:

$$E_{T_k B_k} = \frac{T_k \times B_k}{B_k \times T_k}$$

and the base to income elasticity by:

$$E_{B_k Y} = \frac{B_k \times Y}{Y \times B_k}$$

where; T_k = Revenue from the k^{th} tax

Y = GNP

B_k = Base of the k^{th} tax

See Mansfield, 1972.

7. Calculating a tax effort index for an individual country involves a process of removing discretionary effects of tax policy on revenue collections. Following the Sahota-Prest method (see Thac and Lim, 1984), this can be accomplished in a very rough manner by subtracting from (adding to) the actual tax collected each year, the amount claimed due (lost) to discretionary action as announced in the budget speech of that year. This adjusted figure now approximates the level of collections that would have been raised had the discretionary action not been instituted. In addition, since all changes have effects on all subsequent years aswell, it is also necessary to adjust all future years tax receipts with this calculated adjusted factor for each year. In this

way it is possible to obtain the data for deriving a rough measure of the effects of discretionary action on revenue collections.

The next step is to apply the calculated data to the following equation:-

$$\text{Log tax} = \log A + B \log \text{GDP}$$

If the actual tax collections are used in the equation then B is simply the estimate of tax bouyancy. Alternatively, if the adjusted figures are used then B' is a rough estimate of tax elasticity. The size of the difference between these two values (i.e., $(B-B')/B' \times 100$) can then be used as a proxy measure for tax effort. A relatively high value would then reflect a relatively high degree of tax effort and so on (see Thac and Lim, 1984).

8. The effect of fiscal drag, essentially an unlegislated increase in tax rates is in terms of this calculation included in tax elasticity. This tends to cloud the issue partially since with rising inflation rates, government is able to let rates rise automatically without need for discretionary action.
9. Workers who earn below R 8 000 are not liable for returns. However, they must still complete an IRP2 form and depending upon the individuals dependancy pattern may be entitled to claim a refund at the end of the tax year (see Schalkwyk, 1984).

Chapter Four

1. See also Hudson, Jacobs and Biesheuvel (1966), and Charney (1983).
2. An important issue in the 1924 election was, however, the question of gold mining taxation (see Kaplan, 1977:155). Also, it is interesting to note that the 1986 HNP manifaesto promises that if elected they would overhaul the tax system and redistribute the wealth back to Whites (see Weekly Mail, Vol.2 April 11, p.2, 1986).
3. In both these studies, the 'economic issue', as distinct from 'status', 'cultural', 'race' and 'security' issues, is broadly defined to include a whole wide range of economic variables, including; tax, inflation, unemployment, and the cost of living.
4. 323 000 taxpayers units represent at most 626 000 adults

(i.e., joint taxation). Hence at least 1.35m - 626 000 registered voters did not pay any personal income tax.

5. Married persons, including the loan levy.
6. Although the inclusion of disenfranchised Indians and 'Coloureds' partially complicates the tax stats, the numbers involved, especially in the early years, are small enough to be ignored without jepordising the argument.
7. This point is crucial. In other words, it is not only the peculiarities of the S.African context which reduces tax issues to insignificance, but also the distribution of the actual tax burden which has ensured that this has remained so.
8. Reported in Star Newspaper, 15 April, 1986: Political Report.
- 9.

PERIOD ENDING 31.12.	STAT* RATE c/R	PERIOD ENDING 31.12.	STAT* RATE c/R	PERIOD ENDING 31.12	STAT* RATE c/R
1947	20	1960	30	1973	43
1948	20	1961	30	1974	43
1949	20	1962	30	1975	42
1950	20	1963	30	1976	43
1951	22.5	1964	30	1977	49
1952	25	1965	31.5	1978	49
1953	27.5	1966	33	1979	48
1954	25	1967	40	1980	46
1955	25	1968	40	1981	42
1956	25	1969	40	1982	42
1957	32.5	1970	40	1983	46.2
1958	32.5	1971	41	1984	46.2
1959	32.5	1972	43	1985	50

Source: Dept. of Inland Revenue, Annual Reports, 1947-1985

THE STATUTORY NON-MINING COMPANY TAX RATE, 1947 TO 1985
*(including loan levy and surcharge)

Chapter Five

1. Lipton (1985:9) even goes as far as to argue that the basis for such analysis would in any case be weak since 'institutional factors' suggests that South Africa does 'not conform to the marxist model of the State as a instrument of capital.

2. This of course assumes that companies do in fact actually bear at least part of the company tax burden. In a general equilibrium framework for example, it might well be argued that companies actually pay little or no tax at all given their ability to shift the tax burden forward onto higher prices etc. In terms of the marxist approach, however, this would not refute the idea that companies pay little tax but rather have the effect of reinforcing it.
3. This is because UPT is not a full-blown tax per se, but rather a device aimed primarily at encouraging dividend payout rather than one aimed at raising revenue. The validity of the general argument does not change however.
4. As one critic put it: 'Small businesses - wholesalers, retailers and service and property companies - often end up paying the full wack out of profits (See The Argus, 12/12/185).
5. Primarily through the initial and investment allowances. The former accelerates the wear and tear allowance, whilst the latter simply represents a tax gift over and above the cost of the asset.

APPENDIX

At present, no consistent set of government revenue statistics exists which extends over the full post-war period (1946-85). As a result, for purposes of analysis, it was first necessary to construct a comparable time series.

In compiling this set of figures, three major statistical sources were used, namely; The Budget speech's Statistical Reviews (i.e., White papers on the Budget speech): all years, SA Stats (all years), and the SA Reserve Bank Quarterly Review (1970 onwards). The data was then compiled in a format resembling the one set out in the 1985/86 Statistical Review.

In addition, in order to ensure comparability sufficient for our purposes the following major changes were accounted for:

1. The Revenue and Loan Accounts which existed separately prior to 1976/77, were merged into the present format.
2. The Bantu Education Account, which existed separately for the period 1955/56 to 1972/73 was added back into the original accounts i.e., all transfers and credits to this account were added back to Total revenue collections under the heading 'other revenues'.
3. The South-West Africa Account which was in operation for the period 1969/78 to 1980/81 was removed entirely.
4. The Post Office Account which was granted autonomy in 1969/70 was removed entirely.
5. Super tax and Normal tax receipts from Individuals were combined together under the heading 'Individual Income Tax' for the period up until the 1959/60 fiscal year.
6. Interest payments made by the SAR&H (now SATS) which were included in State Revenue Fund since April 1976, were excluded. Similarly, interest payments by the provincial authorities have not been shown as income to the Fund, since 1977.
7. Consistent with the Budget statements and the definition of Ordinary revenue, Customs duty is expressed NET of Customs Union Agreement payments so as to indicate the revenue as it is actually available to government.

Two other changes which occurred in the collection of revenue by Central government were NOT been accounted for. These changes relate to the taking over by the Central government of Company Income tax and Personal (Individual) Income tax in 1957 and 1971 respectively. Since these two changes reflect dynamics of the revenue collection process, no consolidation was required.

DATA FORMAT

The following data format, which incorporates all the major tax and revenue collections for the whole period was used as the framework for the consolidation of Table A. As stated above, this format is not unlike that used in the Budget Statistical Review, 1985/86.

CUSTOMS AND EXCISE

CUSTOMS DUTY ³	RXXX
EXCISE DUTY.....	RXXX

INLAND REVENUE

INCOME TAX

COMPANIES ¹	RXXX
INDIVIDUALS.....	RXXX
GOLD MINES.....	RXXX
OTHER MINES.....	RXXX
SALES DUTY AND GST ¹	RXXX
GOLD MINING LEASES.....	RXXX
NON RESIDENTS' SHAREHOLDERS' TAX.....	RXXX
STAMP DUTIES AND FEES.....	RXXX
TRANSFER DUTY.....	RXXX
ESTATE DUTY.....	RXXX
INTEREST AND DIVIDENDS.....	RXXX
OTHER.....	RXXX
TOTAL INLAND REVENUE.....	<u>RXXX</u>
TOTAL ORDINARY REVENUE.....	<u>RXXX</u> ²

1. Excluding amount payable to the TBVC countries and self-governing States
2. Excluding Standing Allocations of revenue and Loan Levy
3. Net of SWA Central Revenue Fund and Customs Union Agreements

FISCAL YEAR ENDING	CUSTOMS DUTY	EXCISE DUTY	COMPANY TAX	INDIVIDUAL INCOME TAX	GOLD MINING TAXATION	OTHER MINING TAXATION	SALES DUTY AND GST	GOLD MINING LEASES	NON-RESIDENTS' SHARE-H TAX	STAMP DUTIES AND FEES	TRANSFER DUTY	ESTATE DUTY	INTEREST & DIVIDENDS	OTHER	TOTAL INLAND REVENUE	TOTAL ORDINARY REVENUE
1946/47	49	36	16	45	22	2	0	0	3	9	6	3	7	16	130	214
1947/48	45	38	25	56	11	3	0	1	3	8	7	3	8	17	142	225
1948/49	49	37	33	61	13	5	0	2	4	7	7	3	9	20	164	250
1949/50	29	39	37	70	21	4	0	2	5	6	5	3	10	29	192	260
1950/51	34	40	37	66	40	7	0	5	5	7	7	3	12	16	205	279
1951/52	42	44	44	85	41	11	0	4	7	7	10	3	13	42	267	353
1952/53	38	59	59	106	32	12	0	0	8	9	10	3	14	39	292	389
1953/54	48	64	99	118	22	19	0	3	8	9	12	3	14	23	330	442
1954/55	51	68	106	108	26	16	0	3	9	10	14	3	16	26	337	456
1955/56	61	74	108	100	30	17	0	4	10	10	12	3	17	35	346	481
1956/57	65	76	124	106	29	20	0	4	11	10	11	3	19	38	375	516
1957/58	76	81	117	111	30	19	0	5	12	11	12	4	20	29	367	527
1958/59	75	104	120	106	32	14	0	5	13	12	11	4	25	30	372	551
1959/60	87	117	118	107	47	15	0	7	12	12	12	5	27	23	385	589
1960/61	90	123	121	95	59	19	0	14	11	13	11	5	29	30	407	620
1961/62	81	114	126	102	68	21	0	17	10	13	10	5	34	22	428	623
1962/63	91	138	148	101	84	21	0	23	10	14	13	6	35	17	472	701
1963/64	99	157	171	158	87	20	0	30	12	17	19	10	38	24	586	842
1964/65	108	185	219	177	89	21	0	32	13	21	21	11	41	20	665	958
1965/66	114	181	268	197	92	19	0	36	14	20	15	11	44	52	768	1063
1966/67	118	222	276	247	93	25	0	35	16	20	18	20	50	34	834	1174
1967/68	124	262	340	276	90	40	0	33	27	23	23	20	57	28	957	1343
1968/69	141	276	377	306	85	55	0	33	32	33	22	21	77	201	1242	1659
1969/70	181	312	496	275	94	69	94	33	32	53	48	28	86	140	1448	1941
1970/71	204	347	617	457	87	65	135	32	35	47	48	26	99	58	1706	2257
1971/72	204	389	636	587	98	33	177	32	33	46	42	29	227	43	1983	2576
1972/73	169	419	730	762	162	49	181	53	41	54	50	29	272	82	2465	3053
1973/74	226	490	918	900	352	82	195	104	57	81	69	30	284	170	3242	3958
1974/75	310	529	1117	1077	575	87	181	182	83	81	63	35	327	161	3969	4808
1975/76	355	615	1452	1353	466	51	215	176	90	73	61	38	388	154	4517	5487
1976/77	330	828	1568	1690	296	69	273	112	85	71	53	43	468	164	4892	6050
1977/78	540	860	1680	1879	347	109	336	98	93	83	48	45	529	102	5349	6749
1978/79	453	964	1549	1974	666	127	775	196	111	94	53	46	649	527	6767	8184
1979/80	322	1013	1833	1944	1167	282	1248	334	162	124	89	58	662	589	8492	9827
1980/81	274	1243	2417	2090	2795	211	1653	838	297	138	154	61	572	606	11832	13349
1981/82	758	1503	3121	3163	1542	104	2116	589	323	144	172	67	501	568	12410	14671
1982/83	901	1624	3662	4288	1278	200	3184	368	245	148	191	85	572	676	14897	17422
1983/84	472	1710	3256	5674	1701	151	3877	521	259	210	317	87	509	591	17153	19335
1984/85	280	1885	3864	7438	1640	221	5878	386	220	250	280	95	515	1133	21920	24085
1985/86*	300	1875	4250	8620	1900	251	7080	450	220	260	250	100	502	822	24705	26880

*Provisional

Source: Appendix

TABLE A THE COMPOSITION OF CENTRAL GOVERNMENT ORDINARY REVENUE COLLECTIONS (R.MILLIONS), BY SOURCE, 1946/47 - 1985/86.

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