‘The debate over land will occupy more of our time. Answers must be found, and quickly too. This is particularly so in the light of sentiments in predominantly black areas and after the recent elections. Stephen Meintjes and Michael Jacques have set out in *Our Land, Our Rent, Our Jobs* a comprehensive exploration of ways in which there can be a shift away from taxation of our labour and capital to the collection of land rentals instead, both in South Africa and elsewhere, which will stimulate growth of both small and large businesses.

‘Let the ideas in this book be looked at with an open mind. They could be slotted into traditional beliefs, accepted in part, or even scrapped in their entirety.

‘But they must be debated, for only in this manner can solutions to the crisis be found.’

Dr Thami Mazwai

* * *

‘This is a well-researched book that confronts an uncomfortable yet inevitable discussion.

‘Leaders across the continent have been considering policies that have had limited success in the past. A “land rent” based approach could answer some developmental questions for the continent. If Africa can quantify its immense resource potential and harness it through an effective land rental regime, underdevelopment and poverty can be effectively tackled.’

Percy Takunda

‘Steve Meintjes with his background of being a student of history, law and investment analysis, makes a massive contribution to South Africa and potentially the world with this visionary book. Together with his friend, the late Michael Jacques, he challenges us to totally rethink the nature of taxation. They propose a radical change – but one that falls neatly in line with the Freedom Charter and the Consititution.

‘Given the challenges of finding an equitable and efficient system for raising revenue, their proposals cause us to think creatively “out of the box”.

‘In so doing they also provide a refreshing look at how South Africa’s pressing problems of job creation, rapid economic growth, revenue shortfalls, corruption, and poverty can be alleviated.

‘There is a compelling logic to their argument and they present practical ways and means for this alternative system to be introduced. Their comprehensive analysis relating to various sectors of the economy is commendable. This new concept (albeit old in its origin) stimulates us mentally and is worthy of serious consideration.

‘Much detail needs to be worked through and the book is intended to stimulate thoughtful contributions from Economists, Businessmen, Politicians, the Treasury, Academics, and Students – as well as all those who would like to see the South African economy lifted onto a strong growth path for all.’

Kennedy Maxwell

OUR **LAND** OUR **RENT** OUR **JOBS**

Uncovering the explosive potential
for growth via resource rentals

Stephen Meintjes | Michael Jacques

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Foreword

THIS BOOK IS, in a sense, immediate and topical and in another, universal and timeless. The former refers to the ongoing debate on the nationalisation of mines and the redistribution of agricultural land. Rent arises in the consideration of the optimal and productive allocation of resources. By this common definition, rent is understood in a very limited and not entirely accurate sense as referring to returns and particularly the (super) profits accruing to owners of resources for their use by others. The crisis then is inequitable ownership of resources and the legitimacy of existing property rights. This has been the emphasis of current discourse insofar as it is applicable to land in the strict sense and its use for primary production.

Much more subtle, and often overlooked, is the sense in which rent arises in the context of the reproduction of resources in the theory of value. The Ricardian conception of economic rent qua locational advantage that should accrue to any factor of production, including land itself for its use in production, is both more relevant and general. It relates returns to factors of production to the margin of production, which is the production generated on the best available rent-free equivalent. Rent, then, is the difference between the productive capacity of a factor and its margin of production. By this definition, the usual relationship between productivity and returns is spurious because it neglects that the monopoly power of owners of resources derives from locational advantages and not from the appropriation of marginal returns. The associated returns are then much higher and so a large proportion of revenue remains uncollected for use elsewhere. By this understanding characteristic crisis is a tendency towards stagnation; the increasing, successive underutilisation of resources.

It is the adverse consequence of the misappropriation of rent by the second definition that explains the secular decline apparent in South Africa today. All actual returns have systematically diverged from potential returns. Land, labour and capital all earn lower returns than those suggested by potential returns. This book applies this observation in explaining that both urban and rural resources lie redundant. The issue is not that resources are scarce and concentrated. It is that a staggering number of existing resources are not in use at all. It is this that policy should seek to address. This book can then be understood as illustrating what might happen in the event that it does not.

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Preface

Collecting the resource rentals that belong to the people of South Africa

WE SEEM TO have reached some sort of consensus – at last. Poverty is the real issue. Employment, with real jobs, is the single most critical social and economic issue to be resolved in South Africa today – and this needs to be tackled with the utmost urgency. As it happens, the solution is obvious and to hand. We will argue that, at its root, the problem really stems from a failure of the taxation system – a failure to collect natural and community-created rentals. Destructive taxes on labour and consumption, such as PAYE and VAT, are not only stifling economic growth, but are the principal cause of the apparently intractable unemployment problem. Regressive taxation oppresses the poor and depresses economic activity in marginal areas, which is exactly where job creation requires stimulation. Moreover, even in prime, mostly metropolitan areas, full collection of these rentals would provide the stimulus that is distinctly lacking in the prevailing situation of gross economic underperformance. The solution: collect the rent, stimulate rapid economic growth, and finally release the grip of the dead hand of taxation on employment.

Our argument is simply that South Africa can eliminate unemployment and achieve rapid economic growth by collecting the natural and community-created rentals on land and other natural resources instead of inflicting mostly destructive taxes on labour and consumption.

The practical proposals that follow show that the collection of resource rentals in a developing economy like South Africa's can take effect in a surprisingly short time.

Right at the outset, however, we need to recognise that this situation is a part of a global phenomenon.

So what, then, has the global credit crisis, for example, got to do with our proposal that South Africans act like owners of their own land and other natural resources by charging a rental for their use, instead of taxing themselves for working and risking their capital?

Well, everything actually.

For a start, houses – the decline in prices of which sparked the sub-prime and then the global credit crises – are still, even in this era of technology, built on land! And, as we shall see, if our proposals had been adopted, the crisis simply could never have happened.

'We must get homes for the poor.'

The roots of the crisis lie deep indeed, but the seemingly laudable aim to extend home ownership to record levels, which motivated the Clinton Administration in 1992, is a good place to start. Clinton's Housing and Urban Development Agency took aim at the banking criteria that seemed to exclude the poor from ever owning a roof over their heads, and strong-armed the banks into granting more mortgages. Not only were practices such as redlining strictly forbidden, but lending performances were closely scrutinised for evidence of prejudice against minority groups, especially Hispanics and blacks.

After initial protests, not only did banks eventually make millions from these loans, but they thought of wheezes to turn the whole process to their advantage. Since it was recognised that loans to individuals with poor payment or employment records were indeed 'sub-prime', banks 'sliced and diced' or put them into packages with varying grades of better-quality mortgages. Lo and behold, this process of securitisation, blessed by the profligate issue of credit default swaps by the giant insurer AIG, led supposedly strict ratings agencies to give these packages investable ratings. This enabled them, together with other 'asset backed securities', to be taken off their balance sheets and sold worldwide as safe, high yielding investments suitable for pension funds, and widows and orphans. Instead of the traditional, more modest profits on mortgage loans advanced and paid back over 20 years, the banks were able to make the raising fees and on-selling profits again and again. This practice, aided and abetted by remarks from Greenspan and Bernanke to the effect that 'long-term, house prices do not decline,' helped pump up the property bubble, which, in turn, provided collateral for the mega-loans advanced by investment banks for hundreds of massive mergers and acquisitions, many of which failed to enhance economic productivity. And the rest, as they say, is the history of why we are where we are.

'Yes,' you may say, 'so land speculation lay at the heart of the global credit crisis, but how would our proposals have prevented this from happening and what was wrong with Clinton's idea in the first place?'

The myth of ever-rising house prices

Unimproved land prices are the market's best estimate of the present value of uncollected land rentals. Had these been collected by the government, rising land prices, on which the myth of ever-rising house prices was based, would not have been available for collateral. Housing loans, therefore, would have been just that, i.e. for the bricks and mortar and not the land. With no capital payment for land, houses would have cost a lot less as well! As we shall see, failure by government to collect rising land rentals has enabled banks to default to the somnolent model of a collateral-based lending order, which has encouraged excessive consumption and deficient production. Because land values naturally increase with rising populations and increasing productivity, land prices have, in the absence of land rental collection, tended to increase accordingly. Since every man and his dog understands the long-term trend – and bankers have often been all too obliging – speculation usually drives land prices way past any reasonable estimate of the present values of uncollected rentals. Hence the long-term prevalence of cycles of boom and bust.

So what about our jobs?

The global credit crisis might well seem worlds away both in time and causality from South Africa in 2014 amid huge anxiety around job creation. But we are following the same model and we, too, will go nowhere unless we change it! Yes, South Africa was fortunate enough to have stuck to relatively responsible fiscal and monetary policies as well as, at a crucial time, to have wisely reigned in irresponsible lending with the National Credit Act. We are also fortunate enough to have seen from a distance how the American political and financial sectors combined to pump up mainly land-based collateral, from subprime mortgages to the mega-billions in exotic securities traded on Wall Street, with disastrous economic consequences. How many of your banking friends are prepared to tell you with a straight face that our much-maligned exchange control did not play a role in preventing us from following suit? The fact of the matter, as we hope forcefully to show, is that the deeply flawed Western banking systems are a direct outcome of the fundamental failure of governments to collect land

and other natural resource rentals. Their taxation instead of economic activity is likewise hugely destructive of jobs.

Why South Africa?

In a way this is a silly question. Yet we have to ask it because our proposals mean we have to take a lead, and so far, all we have done is timorously follow some (by now discredited) Eurocentric economic models. We will answer this question at length, but right now we can say we have much more going for us than even our optimists think! For example, until recently, we had one of the world's most successful and widely applied municipal site value rating systems (the abolition of which in Johannesburg, at any rate, has led to the proliferation of blackjack farms). Even the horrendous Anglo-Saxon land ownership model results from a Norman overlay on a relatively egalitarian society and land tenure system, with some features not far removed from the traditional African tribal model. For the most part, our Roman Dutch system of land tenure is well-suited to the higher levels of transparency in ownership that will be required to implement the necessary changes. Then again, from the most unlikely source, i.e. gold mining, we have a tried-and-proven tax system that readily lends itself as a means of collecting natural resource rentals for the mining industry as whole. But above all, South Africans, with their love of the land, are not about to fall for the accounting practices that allow land to dwindle to insignificant proportions on company balance sheets, nor will they accept economic models that treat land as 'no different from any other form of capital'. We all, without exception, understand the importance of land! Finally, the desperation with which 'new' plans are formulated for growth is directly related to the huge need for jobs. There is a limit to the efficacy of 'plans burble' in warding off mass discontent. Yes, action is required rather than proliferating red tape. But actually it's just the tax jungle that needs clearing. It's taxes that are shackling growth! It's their replacement by natural resource rental collection that will incentivise businesses and turn the former homeland sinkholes of poverty into thriving growth partners for the rest of South Africa.

How?

So how do we propose to collect this rent, and we are sure you're also thinking, 'Would it be enough and wouldn't it be too radical for the economy and foreign investors to stomach?'

Well, the answer to this is that after a few chapters dealing with why we should collect rent, most of the remainder are about the nitty-gritty of how it should be done.

We will spell out how a rental can be collected equal to the annual market value of the permanent use of a particular piece of land or other natural resource. In principle, this will replace taxation, except on activities that the community explicitly wishes to discourage. Yes, there will be some exceptions and a phasing-in period, as well as special measures for collection of rent in various areas such as the mining and fishing industries, as well as the use of the electromagnetic spectrum. Yes, there will also be arguments about the value of particular pieces of land and other natural resources; but in contrast to the sterile debates on tax evasion and avoidance, they will be productive because they will relate to the best use of our patrimony. Tax dodging will become history, since you cannot hide South African land or park it in Bermuda!

Finally, we will show that collecting the rent is not simply another proposal for tinkering with the tax system, but is about unleashing a mighty force for economic regeneration and vitality. Here's how:

- Since they will be paying in full for it anyway, whether they use it efficiently or not, all landowners, urban as well as rural, will be incentivised to maximise production.
- Withholding land from use, or underutilising it, for speculation, won't pay any more: it will be 'use it or lose it' throughout the economy.
- Replacing all indirect taxes with natural resource rentals will be a huge boon to all sites with minimal locational advantage, such as many of our rural areas, and hence, there may be little or no resource rental to pay, so economic activity there can thrive and survive even during tough times.
- By the same token, the South African Revenue Services will no longer be the bogeyman chasing marginal businesses for VAT and PAYE and pushing them into bankruptcy.
- Effectively, this will revitalise economic activity in all the depressed rural areas that 'support' nearly half the country's population.
- Given the direct link between the quality of service delivery, land values and their income, government at all levels will have a much more powerful incentive to deliver.

- Sterile tax debates and avoidance stratagems that consume billions become instead an examination of the best use of natural resources.
- By immediately providing all people with the full value for all their land, the deep-seated and emotionally explosive attitudes around land reform will be defused.
- Ongoing programmes for a better distribution of land ownership can proceed in a much more constructive context.
- With one of the most profound causes of poverty and unemployment laid bare, labour and business will see that they are partners rather than adversaries. This, in turn, will lead to the easing of many regulations stifling business and aborting jobs.
- Mass housing – currently a big white elephant in many rural areas – will not only be cheaper, but will actually attract businesses to what will be in effect any number of 'tax-free' zones.
- Banks will be incentivised to lend more for production rather than consumption or speculation.
- With businesses in prime areas really incentivised, and with the rural areas becoming a new 'trading partner' instead of being a millstone around the neck of the economy, economic growth will accelerate so as to enable the National Development Plan to surpass its otherwise unattainable aspirations.

In short, to explain 'how' is why we are writing this book, which we hope, will be interesting; not least because it shows how we can and must do away with most taxes! Nor do we pretend that our 'how' is the last word on the subject. Far from it. But if it stimulates vigorous debate on the best ways to do it, we will have achieved our goal. We have faith in the acumen of our business folk and economists, as well as the common sense of our people to see it through. So, while the present system is battling in vain against the forces of nature, we propose to harness and unleash them so as to achieve that level of abundance which is appropriate for the dignity of all South Africans, and is their natural birth right.

Michael Jacques and Stephen Meintjes
2013

CHAPTER 1

TAXES, PLEASE, OR ELSE!

'To tax and to please, no more than to love and be wise, is not given to men.'[1]
Edmund Burke

Why we pay our suppliers …

A dialogue

Question: Why do you pay your suppliers?

Answer: Assuming that's a serious question, I pay my suppliers for two main reasons. First, I have a contract – sometimes verbal, but generally in writing – in the form of an order; secondly, if I don't pay them (assuming they delivered the right goods or services on time and at the agreed price), my supplies will be cut off and my business will grind to a halt.

Question: OK, next question: why do you pay your rent?

Answer: As with the first question, because I have a contract with the landlord that allows me to use premises that at present are optimal for my business; that is suitable premises in the right location for a good rent.

Question: Finally, why do you pay your taxes?

Answer: Now you're talking! Simply because if I don't, my business will be closed down and I'll probably end up in jail or bankrupt. With the other two questions there is a definite quid pro quo: arm's length transactions where I pay for what I get. If I can get a better deal elsewhere, I'm free to take it up. With taxation, I have no such choice (other than to move my business to another country) and quite

1 *Thoughts on the Cause of the Present Discontents*, 1770.

frankly, it is difficult to see what direct benefits I receive. As for the direct benefits I do get, like utilities and garbage collection, I pay for them anyway.

Question: So what you are saying is that while tax is a business expense like supplies and services, wages and rent, tax does not have the same relationship to your business output that the other expenses have?

Answer: Well, income tax does have a loose relationship with the profits I make, but one couldn't cost this into the selling price of my products or services. Then there are a myriad other taxes: some of these, like customs and excise duties can be costed into the relevant products, but many taxes are so sneaky that we hardly know they exist. The problem with this is that most businesses try to overcompensate for these taxes in their product pricing. If you can get away with it, fine, but this must be inflationary.

… is not for the same reason we pay tax!

Taxes have been extracted from citizens by brute force since people started living in homogenous social, religious or economic units, known as states, ruled by a governing entity that has power over its citizens.

The ancient Persian ruler, Artaxerxes (ca. 440 BCE), put it like this: 'The authority of the prince must be defended by military force; that force can only be maintained by taxes; all taxes must, at last, fall upon agriculture, and agriculture can never flourish except under the protection of justice and moderation.'[2]

So first of all, the authority of the prince (government) must be defended by 'military force' (army and police). Today we can add treaties with other countries and the nebulous concepts of patriotism, nationality and citizenship. In modern times, these matters require organs of state that go way beyond just the army and police. And these organs of state can only be maintained, as Artaxerxes puts it, by taxes.

Then he says, 'All taxes must, at last, fall upon agriculture.' Today we could say 'any wealth-producing activity'. The words, 'at last', are taken to mean 'when it can no longer be passed on to anyone else'. So regardless of how (or from whom) a state tries to collect its taxes, they can, at the end of the day, only be paid by a wealth-producing entity.

2 Gibbon, E., *The History of the Decline and Fall of the Roman Empire*, Methuen & Co., London, 1909, p.228.

Brute force apart, is there any reason for this universal, albeit reluctant, acceptance of tax?

The concept of taxation goes back in time well before that of Artaxerxes. Probably hundreds of different types of taxes have been imposed over the millennia and they all have one common feature: they were imposed by rulers who had the power to do so. So over time, taxation seems to have been built into our social and economic genetic structure, and today almost everyone accepts it as a necessary evil.

How did taxation, which is not a factor of production, come to claim such a large portion of wealth and then, in value-added financial statements, come to usurp a place as a factor of production to which wealth must be distributed? It is all very well to say that governments collect taxes because they have the power to do so, but surely there must be some historical basis for this weird system?

The question that needs to be unravelled, however, is how this universal acceptance came about over many centuries. To do this we will look – hopefully as briefly as possible – at the economic and socio-political histories of three countries: Britain, the United States of America and Brazil.

How it came about in Britain

In Britain, the Norman Conquest of 1066 heralded a far-reaching change in the tenure of land. In Saxon times, land was held by individuals in a loose and complex system.[3] After the Conquest, land was held, to put it very simplistically, by the king. This meant that the king could hand out land to favourites and in time, powerful barons came to own large tracts of land – a situation that persists, to a large extent, to the present time.[4] As parliamentary democracy evolved over the centuries, those who controlled the land effectively controlled the parliamentary process. Even when universal franchise was introduced, an upper house of parliament, the House of Lords, comprising mainly hereditary landowners, still had the last say in the adoption of legislation passed by the House of Commons, the lower house of Parliament.

3 'But even in Wessex the idea still persisted that the tie of Lord and man was primarily personal, so that a free man could go from one Lord to another and transfer his land with him.' Winston Churchill, *A History of the English-Speaking Peoples*, Cassell & Co., London, 1957, vol. I, p.137.

4 This lengthy process is described by Sir Kenneth Jupp in *Stealing Our Land: Law, Rent, and Taxation*, Othila Press Ltd., London, 1997.

Adam Smith presented his great masterpiece, *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, a time of revolution, change and upheaval. It was at the cusp of the change from a simpler, more agricultural way of life, to a more modern world of industry, commerce, finance and new socio-political dynamics. Smith alludes to this change in '*Of the Funds or Sources of Revenue which may peculiarly belong to the Sovereign or Commonwealth*', where he deals with this simpler, less sophisticated state, but ends this short part with these words: 'Public stock [capital] and public lands, therefore, the two sources of revenue which may peculiarly belong to the sovereign or commonwealth, being both improper and insufficient funds for defraying the necessary expense of any great and civilised state, it remains that this expense must, the greater part of it, be defrayed by taxes of one kind or another; the people contributing a part of their own private revenue in order to make up a public revenue to the sovereign or commonwealth.'[5]

Smith then starts his great dissertation, '*Of Taxes'*, and this goes on for a further 83 pages. But it is in the words above and in his part on taxes that Adam Smith gives the modern, industrialised state 'permission' to levy taxes on its citizens. He lays out the framework of taxation in his four maxims of taxation (generally called the 'canons of taxation') and describes most of the taxes with which we are familiar today. A careful reader may note that he opposed nearly all of them!

It is interesting that a few years after the publication of *The Wealth of Nations*, William Pitt, the Prime Minister of Britain, introduced income tax for the first time to help pay for the Napoleonic Wars. Did Pitt feel that Adam Smith justified this move? Also, there was an interesting social dynamic at play here. The ruling class (even if not the political party in power) was the aristocratic landed class that dominated the House of Lords, and was not to be confused with the wealthy merchants and bankers. By the middle of the eighteenth century, taxation comprised mainly a land tax, or, as Adam Smith called it, 'Taxes upon the Rent of Land', as well as various customs and excise taxes. The land tax was, of course, paid by the (rural) landed classes. Churchill, referring to the political situation in the mid-eighteenth century, alludes briefly to this: 'Taxation was low; the land tax, which was anxiously watched by the Tory squires, was reduced by

5 Smith, A., *An Inquiry into the Nature and Causes of the Wealth of Nations*, The Modern Library, New York, 1994, Book V, Ch. 2, Part I, p.879.

economy to one shilling.'[6] So an income tax on the merchants and bankers would not be politically difficult, especially if this meant an even further reduction of the land tax.

So while Adam Smith may have outlined our present tax systems and given modern economists justification for their tax theories, he certainly did not start the change from simpler agricultural taxes to more complex income and consumption-type taxes. There were far greater dynamics at play. First, the state was getting larger and more expensive to run and warfare was technologically more advanced, lasted longer and was becoming extremely costly to prosecute. Secondly, there was a far subtler dynamic that stretched back to times when human beings started living in organised communities with a hierarchical ruling structure. It was as simple as this: those who controlled the land controlled the community and the wealth it created. There is nothing good or bad about this: it is just the way things are and always have been. Socialists who don't like this system and who have had the chance to overthrow it, usually create a new class of rulers who are generally more dictatorial and less democratic than the previous lot (but still control the land and the wealth produced).

The point is that as countries adopted the tax systems that we are familiar with today, one could see the hand of the land-owning classes guiding taxes away from anything that would harm land values and on to taxes that *they* considered to be 'fair and equitable' (like VAT). What they really mean to do is introduce taxes that will increase the value of prime land. In Britain, as mentioned above, the land-owning aristocracy was the real power behind any elected political party, and they showed their hand when David Lloyd George, Chancellor of the Exchequer in the Liberal government, introduced a land tax in his 1909 budget. This was immediately rejected by the House of Lords. While this started a diminution of the powers of the House of Lords, it ended Britain's first real chance to introduce a truly equitable tax.

And in America, despite war about 'no taxation without representation'…

In America, the start of the Republic after the War of Independence was dominated by two opposing forces represented by Alexander Hamilton, the Federalist from New York and Thomas Jefferson, the

6 Churchill, W., *A History of the English-Speaking Peoples*, Cassell & Co., London, 1957, vol. III, p.97.

Virginian democrat. Churchill describes this battle in detail in his *A History of the English-Speaking Peoples*.[7] It should be remembered that at the end of the War of Independence in 1783, the thirteen states that had signed the Declaration of Independence were joined together by a loose confederation with George Washington as the president. Congress was weak and its proposals subject to veto by any of the states. The post-war dangers (political, economic and international) threatened this arrangement and the stability of the individual states. To address these threats, a convention of the thirteen states met in Philadelphia in 1787. From this convention a new constitution was drawn up, envisaging a stronger, more centralised form of federalist government. But in spite of the dangers facing the newly independent states, the proposals for a more cohesive republic faced fierce opposition.

'To the leaders of agrarian democracy, the backwoodsmen, the small farmers,' wrote Churchill, 'the project seemed a betrayal of the Revolution. They had thrown off the English executive. They had gained their freedom. They were now asked to create another instrument no less powerful and coercive. They had been told they were fighting for the Rights of Man and the equality of the individual. They saw in the Constitution an engine for the defence of property against equality. They felt in their daily life the heavy hand of powerful interests behind the contracts and debts which oppressed them … But the party of Hamilton and Morris, with its brilliant propaganda … carried the day … On April 30, 1789, in the recently opened Federal Hall in New York, George Washington was solemnly inaugurated as the first President of the United States. A week later the French States-General met at Versailles. Another great revolution was about to burst upon a bewildered world. The flimsy, untested fabric of American unity and order had been erected only just in time.'

One of the issues behind the conflict between the agrarian democrats and financiers of New York, was a proposal by Hamilton for the new government to take over the bonds and certificates issued by the thirteen states to fund the War of Independence. According to Churchill, 'The moneyed interest was overjoyed by this programme, but there was bitter opposition from those who realised that the new government was using its taxing powers to pay interest to the speculative holders of state debts now assumed by Congress … In Virginia there was fierce revolt against Hamilton's scheme. The planters distrusted the whole idea of public finance.'

7 *Ibid.*, vol. III, pp.212-216.

Thomas Jefferson was not present at the Philadelphia Convention; at the time, he was the Confederation's ambassador to France, but returned to become the first Secretary of State of the new Federal government (Hamilton was in charge of the Treasury). Churchill describes Jefferson as 'In touch with fashionable Left-Wing circles of political philosophy in Europe, and, like the French school of economists who went by the name of Physiocrats, he believed in a yeoman-farmer society. He feared an industrial proletariat as much as he disliked the principle of aristocracy. Industrial and capitalist development appalled him. He despised and distrusted the whole machinery of banks, tariffs, credit manipulation, and all the agencies of capitalism which the New Yorker Hamilton was skilfully introducing into the United States.'

What we see in the formation of the United States is the culmination of the spirit of independence that had inspired the early settlers. They left England to free themselves from the stifling constrictions of English political, social, economic and religious hegemony. Nevertheless, they took with them their inbred sense of English justice and equity. These qualities shine through in their early struggles, their fight against British political domination and taxation, and in the formation of the United States of America. While there were strongly opposing factions, it was always a meeting of equals getting together to forge a common destiny. The agrarian democrats may well have seen their cause as the equality of the people against the moneyed interests of the few, but they were just as wedded to the concept of property as the Hamilton-led financiers of New York. And they cherished not only property in land, but in houses, farms, equipment, and, in the South, in people as well. The ownership of slaves, although abolished in most countries in the Western world in the early part of the nineteenth century, was to continue for almost another hundred years after the formation of the United States. It also took a long, bloody and destructive civil war to free the slaves.

Nevertheless, the 'Jefferson-democrats' may well have had a moderating influence on the rapacity of the New York financiers: the US tax system (at least on a federal basis) has steadfastly rejected the inclusion of consumer taxes in the tax code. This has partially been the reason why America still has thousands of relatively prosperous towns and villages spread across this vast land. It has also avoided the agglomeration of huge slums around its major cities.

This, as we shall see, is in direct contrast to the situation in Brazil.

Brazil

Brazil was 'discovered' by the Portuguese almost in error. Following Vasco da Gama's discovery in 1498 of a route to the East around the Cape of Good Hope, a large armada of ships was sent to exploit this route. To avoid the calms around the Gulf of Guinea, the ships veered to the west, and in April 1500, they landed on the coast of Brazil and promptly claimed the land in the name of Portugal.

Initially only the east coast of Brazil was developed by early Portuguese settlers, but the lure of the rich hinterland to the west was too much to resist. The brunt of 'the march to the west' was borne by the Paulistas, the settlers of Sao Paulo who organised great expeditions into the interior, known as bandeiras, to capture Indian slaves and to find gold and precious stones.

An important factor in the unification of the people of Brazil was the heritage of Portugal; the Portuguese language formed a common bond between plantation residents, cattlemen, miners, slaves and city dwellers and the expanded patriarchal family structure, also derived from Portugal, was nearly uniform throughout Brazil. Power was exercised by the heads of those families that controlled the land, slaves, cattle and mines that produced the wealth of the colony.

Unlike the American colonies, Brazil attained its independence relatively easily. The Portuguese king, John VI had taken refuge in Brazil in 1807 to escape Napoleon and when he returned to Portugal in 1821, he left his son, Dom Pedro, as regent. However, Dom Pedro, supported by a majority of Brazilians, declared independence from Portugal and was crowned Emperor in December 1822. The Brazilian monarchy continued until 1889 when Dom Pedro II abdicated after a revolt by army officers and was banished to Portugal.

Brazil as a republic was initially run by the military, and the first civilian president was installed only in 1894. The military influence in politics continued strongly for most of the 20th century and probably even continues to this day. They, in turn, were backed initially by the powerful rural landholders, and later, also by a wealthy and largely urban-based middle class.[8]

Quiet and benign as this alliance may seem, it has been the real power behind all the democratically-elected governments. One of their most enduring legacies has been the tax system. Brazil, along with

8 Based on *History of Brazil*, Encyclopaedia Britannica, Macropaedia, 1978, vol. III, pp.144-151.

many other South American countries, has had one of the world's most extensive indirect tax systems for almost the past fifty years.

According to Organisation for Economic Cooperation and Development (OECD) statistics, Brazil collects about a third of GDP in taxes, which is slightly less than the OECD average.[9] Commenting on this, *The Economist*[10] was heavily critical of the huge burden on the development of Brazil, and showed how taxes as a percentage of GDP are considerably less in Latin America on average (19.4%) as well as in other developing countries such as South Korea and China (the OECD average is raised by developed countries with extensive – and expensive – social welfare systems).

The Economist shows how, in the case of Brazil, such large tax revenues, in the hands of relatively weak governments, can be wasteful and inefficient. Also, where a large portion of tax revenue derives from indirect taxes, this causes a greater divide between rich and poor. It goes on to say: 'Because most revenue comes from consumption taxes, a Brazilian earning less than twice the minimum wage pays out nearly half his income in tax, whereas someone on 30 times the minimum wage pays only about a quarter in tax. Such benefits as pensions and free tuition at public universities flow disproportionately to the well-off.' Not only are poor people paying a large portion of their incomes in (mainly indirect) taxes, but indirect taxes have a constricting effect on rural development, especially where many rural dwellers are poor and illiterate.

South Africa

What then of South Africa? Like Brazil, it is a developing country, also has a huge proportion of under-educated and unemployed poor, and its major cities, like Brazil's Rio de Janeiro and Sao Paulo, gather huge shanty-towns and slums. It is no coincidence that South Africa has, in the last sixteen years, introduced a large number of indirect taxes.

In South Africa today, government revenue is approximately 28% of GDP. While the social and political landscape in South Africa has undergone enormous change since the election of 1994 – mainly for the better – the tax system remains doggedly Western. The only real

9 OECD/ECLAC/CIAT (2012), *Revenue Statistics in Latin America*, OECD Publishing. Statlink: http://dx.doi.org/10.1787/888932691194
10 Special report: Brazil, April 14, 2007.

change is that it has become considerably more efficient and has cast its net ever wider. When Trevor Manuel (a left-leaning firebrand of the old United Democratic Front and one of the main destroyers of apartheid) became Minister of Finance in 1996, his predecessor, Chris Liebenberg, took him on a tour of Western financial capitals. Liebenberg was a highly respected banker with impeccable credentials in global financial circles. Manuel came to meet all the right people in international finance and soon came to learn how the global financial system works. His earlier sarcastic comments about the 'amorphous markets' were quickly forgotten; and Manuel soon adopted the economic imperatives of the Washington Consensus,[11] even though he may hotly deny this. During his long tenure as Minister of Finance he became the darling of South Africa's business and financial community, guiding South Africa's economic revival. At the same time, however, he also saw a steady increase in the wealth gap between rich and poor. So, while South Africa may not have had powerful capitalist interests nudging tax laws in their direction, the politicians of the socialist-leaning government have, perhaps unwittingly, done the capitalists' bidding.

What is wrong with the present system of taxation? After all, the basic principles of modern taxation, which were started in the late seventeenth century in Britain and Europe, have been exported to almost every other country in the world. Even if not greatly loved, taxation is accepted as a necessary evil. While there have been attempts to introduce more equitable systems, these have lasted for a while, but in most cases were overturned by powerful vested interests.[12]

But the tax system is generally accepted because, as we have theorised above, it seems to be ingrained in our economic and social genetic make-up. It's not that people don't want to change the system – every year, just before budget-time, the South African Minister of Finance's e-mail was clogged with citizens giving their 'Tips for Trevor' – but that they are all trying to fix a system that is fundamentally flawed. Also, most 'tips' are really requests to change something that will favour their own personal or business finances.

11 Washington Consensus: this comprised a series of policy prescriptions formulated in the early 1990's by the likes of the IMF, World Bank and US Treasury for crisis-ridden developing economies but, after nearly two decades of assiduous application, including in countries like Zimbabwe, it had largely lost its lustre.

12 For example, Denmark 1957 to 1960: Tholstrup, K., *Economic Liberalism*, 1 Vester Farings Gade, DK 1648, Copenhagen V, Denmark.

Essence of the problem: taxes can come only from earnings of land, labour or capital

The problem, basically, is this: taxes can only come from the earnings of the three factors of production, land, labour and capital, or, as Adam Smith put it, 'Rent, Profit and Wages. Every tax must finally be paid from some one or other of those three different sorts of revenue.'[13] As we have attempted to illustrate above, landowners have always represented a powerful political entity. Today they are no longer only the descendants of 'robber barons', but comprise a large block of any population: ordinary house-holders, farmers, owners of residential and commercial property, and shareholders of property companies. There are also huge emotional issues regarding the ownership and occupation of land. For these and other reasons, the taxation of land is strongly resisted and the bulk of taxes tend to fall either on labour or capital. The arguments against the taxation of land, or to be more precise, the rent of land, are also clouded by emotion: it is tantamount to the nationalisation of land; it is not based on 'ability to pay'; it is difficult to assess; and taxes will not be spread equitably among all classes of society (code for 'the poor will pay almost nothing').

There are also strong arguments against the taxation of labour and capital. Taxes on wages, as Adam Smith pointed out, are really paid by the employer and are a cause of inflation (although he did not use those words). He also pointed out that taxes on consumption (especially the necessities of life) are again paid by the employer. In the case of countries like South Africa and Brazil, consumption taxes have a devastating effect on the unemployed and unskilled poor, many of whom (in South Africa) live on social grants, a goodly portion being clawed back by the government in the form of VAT. Taxes on capital are criticised as being a drag on production and enterprise, and discouraging foreign investment.

However, for all the reasons given above, governments prefer the long and complicated route of taxing labour and capital in spite of the social and economic problems this causes. In the next chapter we will give an analysis of what Adam Smith really said about taxation, without the flim-flam of modern interpretations. In Chapter 3 we will show how the taxation of labour and capital, without considering the real ability to pay, destroys production at the margin, causes unemployment and drives down wages.

13 *Op. cit.*, *Of Taxes*, Book V, Ch. 2, Part II.