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Why South Africa should seriously consider taxing its wealthy citizens

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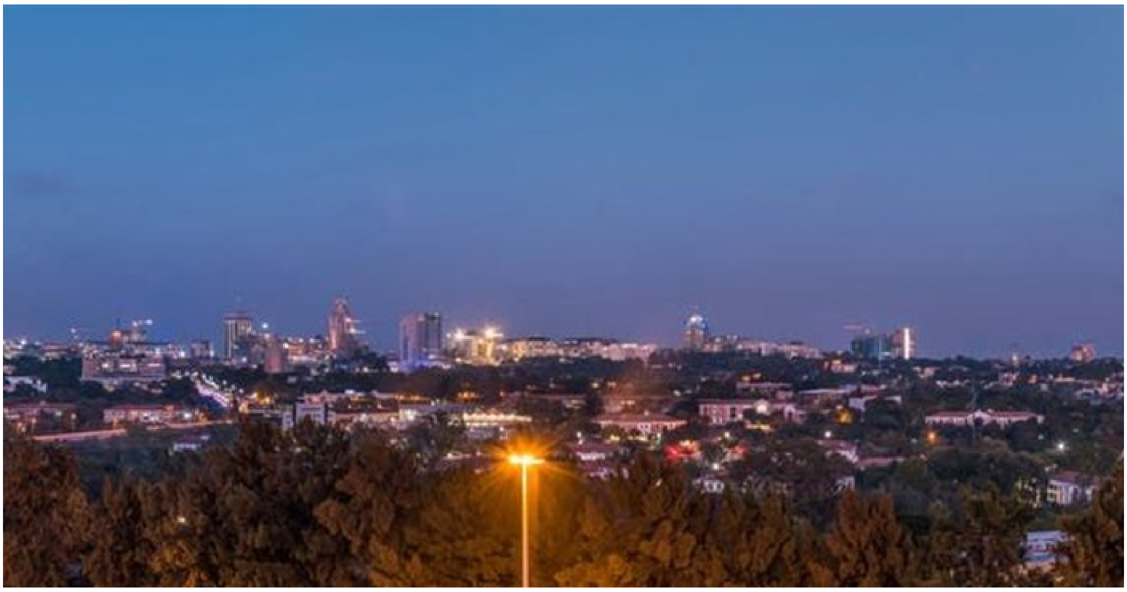
It's well-established that South Africa has one of the most unequal income distributions in the world. Despite significant efforts by the state to stimulate inclusive growth, the income gap between the rich and the poor has continued to widen in post-apartheid South Africa.



Johannesburg's economic hub, Sandton, lies right next to the sprawling and extremely poor Alexandra township.

A less explored topic is that of wealth inequality and, relatedly, the potential use of wealth taxation to reduce wealth inequality while also further diversifying the sources of much-needed government revenue.

An important consequence of a highly unequal distribution of wealth in society is the undermining of social, political and economic norms. For instance, high wealth inequality creates an imbalance of political power between citizens as the wealthy can potentially influence the political process unfairly. This can, in turn, reduce the optimum workings of a democracy.

At the same time, the concentration of a society's wealth in the hands of a few reduces the mobility of wealth. This, in turn, limits its productive use in society.

Given that there are direct benefits from the holding of wealth (over and above the income streams which it generates which are already taxed via the income tax system), we argue that wealth is a legitimate tax base in its own right.

Why a wealth tax

Wealth inequality in South Africa is not only intolerably high, with Gini coefficients of 0.93 in 2010/11 and 0.94 in 2014/15, it is also not reducing. Wealth inequality is much higher than income inequality (which has a Gini coefficient of about 0.67) and significantly higher than global wealth inequality.

In 2015, the wealthiest 10% of South Africa's population owned more than 90% of the total wealth in the country while 80% owned almost no wealth. These findings resonate with more recent findings documented in reports produced by Oxfam (2018) and the World Bank (2018).

There's a clear racial dimension to this inequality with an average African household holding less than 4% of the wealth held by an average white household.

It's a challenge to economic development when the bottom 80% of the population own no wealth, especially when a vibrant middle-class is a key ingredient in economic progression, as evidenced in advanced economies.

Thomas Piketty in his book *Capital in the 21st Century* indicates that much of the economic success experienced in advanced economies in the 20th century has been as a result of increased ownership of assets among the middle-class. This is certainly not the case in South Africa.

Piketty also stresses that wealth inequality is by no means an accident but a product of patrimonial capitalism.

The case of South Africa is unique. In addition to patrimonial capitalism, the prevailing extreme levels of wealth inequality and low inter-generational mobility of wealth are also a result of the structural inequities created by apartheid. These disparities being passed down from generation to generation.

Evidently, effective measures of redress would strongly warrant the intervention of the state.

We therefore propose that the South African government should consider creating an annual net wealth tax with three objectives. The first would be to collect reliable wealth data. This will reveal what people own and enhance the integrity of the income tax system by allowing SARS to compare people's income and wealth. The second would be to contribute towards curbing wealth inequality, albeit imperfectly. The third would be to generate government revenue, though we stress that international evidence suggests this is generally low.

The how

The process of creating a net wealth tax in South Africa should ideally begin with a simple form of an annual net wealth tax. We would suggest that the net wealth tax rate should initially be at a low rate (possibly even zero).

This will allow an assessment of who owns what by making wealth disclosure mandatory for all citizens. This will create an environment of transparency and over time will provide a much clearer picture of the net wealth tax base in South Africa. It would also allow further analysis to help set an effective wealth tax rate that does not promote tax migration and capital flight.

If a non-zero wealth tax rate were to be applied, it should be progressive in nature, for example, by providing a high threshold below which no tax is payable. In turn, this data would provide the South African Revenue Service with improved data to test whether high net worth individuals are being taxed correctly within the income tax system.

The valuation of assets has often ranked high among the list of challenges when creating an effective net wealth tax that keeps costs low. In fact, net wealth taxes have been ineffective in many countries. This has been due to poor or complex methods of valuation, or simply the high costs of administration.

Assets which lend themselves to easy valuation and which could be taxed under a net wealth tax include fixed property. This is already taxed at local government level but could attract an additional national tax. The OECD also supports the idea of taxing property because taxing property has less distortionary effects when compared to other wealth taxes.

Municipal valuations (albeit of varying quality) already exist to provide a good starting point for a national property tax. A national property tax would require a concerted effort to improve the quality of valuation rolls across all municipalities and district councils to avoid the horizontal equity legal challenges seen in other countries (as was the case in Germany).

Cash and some financial assets such as defined contribution retirement funds are easy to value and are thus an easy target for a wealth tax. We would suggest, however, that in an initial net wealth tax, retirement funds should be excluded because of possible distortionary pressures on savings. Currently the retirement of many South Africans is severely underfunded. In addition, it would be inequitable to tax defined-contribution pension funds but not defined-benefit funds (such as the government employees pension fund).

We would also suggest that personal assets such as luxury vehicles, works of art and jewellery be excluded because of valuation difficulties. Worldwide, such assets are under-reported, undervalued and/or hidden.

Conclusion

It's evident that economic inequality is rife in South Africa. Income and consumption inequalities are high and wealth inequality is even higher – much higher than global wealth inequality. Persistent high wealth inequality has the potential to undermine social, economic and democratic values.

A net wealth tax imposed in a society with notorious levels of inequality and a pattern of class overlaid with race, may not be a panacea for the need to generate sufficient revenue to reduce the deficit before borrowing. However, apart from the revenue collected, it would add considerable legitimacy to the overall tax system. Such a tax policy should accommodate a revenue-neutral shift from taxes on employment to taxes on capital and investment income.

It is not our argument that tax is the only available instrument to address the inequities of income and wealth. Other methods of redress include land reform, the provision of infrastructure and increased access to quality health and education.

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