Value Decreased Tax

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The Finance Ministry hopes to "gain" some 1.6 billion NIS by imposing VAT on fruits and vegetables. However, the ministry's calculations fail to take into account the expected change in economic behavior by tax payers as a result of cancelling the benefit. When the price goes up, people consume less – so that total earnings for the state treasury will be much smaller than anticipated. The Finance Ministry itself is aware of this. In the 2008 budget highlights it is written: "A possible decrease in fruits and vegetables consumption as a result of VAT implementation has not been taken into account."

Increasing the VAT rate, as well as imposing it on fruits and vegetables, provides a negative incentive to consume –that hurts employment, the food and agriculture branch, and the health of the poor, while strengthening the bureaucracy.

In the budgetary policy formulated by the Finance Ministry already in 2008, the calculus was that canceling benefits on government taxes would afford an entire policy of decreased taxation. The (theoretical) option was discussed to lower income tax on individuals at every bracket by up to 15%, lowering the corporate tax rate by 4%, and lowering VAT by 1%.

Today in 2009, however, the Treasury prefers to retain the plans to cancel benefits, but forgets the other side of the coin – lowering taxes. The opposite occurs – VAT increases by 1%, and furthermore, for the first time it is imposed on fruits and vegetables as well as other products. But if the Finance Ministry study a year ago demonstrated that lowering taxes is appropriate and will encourage consumption and economic growth, and this is the acknowledged position of the Prime Minister, by what basis was it decided after discussions held for no more than a few days that raising taxes would be beneficial? After all, there is no model proving that increasing VAT will encourage employment and improve the citizens' fiscal condition.

The Jerusalem Institute for Market Studies noted, in a position paper published in response to the proposed budget currently being discussed in the Knesset Finance Committee that the Treasury proposes to compensate the poor by subsidizing public transport or expanding other benefits. The Institute claims that by doing this the government intends to dole out with one hand a large portion of what it takes in with the other, and thus the damage to the public is compounded. Instead of a person standing independently before a fruit stand and deciding whether he can purchase the food, he will stretch out his hand to receive free transportation. The Institute further notes that the tax expansion is intended specifically for fruits and vegetables, a branch that has witnessed a large increase in price over the last few years that is disproportionate to the overall increase in the consumer price index during those years.

While it is true that according to KPMG data, the average VAT rate in the European Union stands at about 20%, outside the union the picture is different – in developed countries 17-18%, in South American around 14%, and in Asia-Pacific, less than 11%. It should be noted that the total tax burden in Israel is high by any standard, as well as the bureaucratic burden on businesses, and we should strive to alter these trends.

The MKs should be aware that there are large countries taking opposite steps that are more beneficial for their citizens. In England, for example, not only food is exempt from VAT, but also medicines, equipment for the disabled, books and many other branches.

The decision by the Finance Ministry to solve economic or fiscal problems by raising taxes causes many problems by punishing the consumer twice, punishing suppliers and sellers of agricultural produce, expanding bureaucracy and more. There is no point in pursuing a mistaken policy and then attempting to compensate for its failures.

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