

BUSINESS INSIDER

Republicans Just Ripped Into One Of Their Own For Mentioning The VAT

Bruce Bartlett, *The Fiscal Times* | Oct. 22, 2010, 12:07 PM | 371 | 7

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An extremely interesting incident occurred on Oct. 14. Republican Indiana Gov. Mitch Daniels addressed the right-wing Hudson Institute and appeared to [endorse a value-added tax](#), something that has been forbidden in Republican circles for the last 25 years.

There was an extremely harsh and negative reaction, providing a good illustration of how Republicans enforce party discipline, create ideological rigidity, disdain rational debate, wallow in self-delusion, and consciously make government unworkable just to achieve partisan objectives.

To begin, the [VAT](#) is a form of sales tax that was invented in Germany about a century ago. Its purpose was to prevent a very serious problem with existing sales [taxes](#), which was that they could cascade as goods were resold, with new layers of sales tax added at each stage. Thus the ultimate tax burden was more a function of turnover than the price of a good or its nature. The result was to impede trade and create economic inefficiency.

The VAT solved this problem by creating an invoice trail for goods that are resold or used as inputs so that resellers could get a credit for taxes that were previously paid. This prevented double taxation and made sure that when goods reached the final consumer they bore only a single layer of taxation, even though the tax was collected in stages. It also improved tax compliance because taxes had to be paid at each stage to qualify for credits on taxes previously paid and embedded in the sale price of goods at each stage.

Another virtue of the VAT is that it can be rebated at the border on exports so that goods bear only taxes imposed by the country of final sale. Virtually all economists believe that this territorial system of taxation is the optimum way of taxing internationally traded goods and multinational corporations. Other forms of taxation, such as the corporate income tax, may not be rebated under international trade law due to uncertainty about its incidence.

This system became very attractive to Europeans as they began the process of moving toward full economic and political integration in the 1960s. With the goal of abolishing all tariffs and trade restrictions in Europe, it was important to ensure that domestic taxes be reformed to prevent cascading



Bruce Bartlett



Bruce Bartlett is a columnist at *The Fiscal Times*.

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as goods might pass through multiple countries on their way to the final consumer. The European Union thus required all its members to replace their general sales taxes with value-added taxes.

Unfortunately, the imposition of VATs throughout Europe took place right on the eve of the great inflation of the 1970s. Because budget deficits and excessive consumption were considered to be prime causes of inflation, many countries raised their VAT rates to increase revenue, reduce deficits and reduce consumption. This proved to be relatively easy because people tended not to notice the difference between an increase in prices resulting from a higher VAT and one resulting from higher oil prices or general inflation.

In the United States, there had long been a number of conservative tax theorists such as Norman Ture, Murray Weidenbaum and Charls [sic] Walker who believed strongly that we should replace the corporate income tax and other taxes on capital with a VAT. They believed that this would raise saving and [investment](#) and improve America's international competitiveness.

Until the mid-1980s, virtually all conservatives agreed with this view. But in 1984, the Treasury Department issued a [study of the VAT](#) that was highly critical. A key argument was that it tended to be a "money machine" that generated revenue too easily, thus fueling an expansion of government. At a February 21, 1985, [press conference](#), Ronald Reagan denounced the VAT in terms that soon became conservative dogma:

I would have great difficulty accepting ... a value-added tax. First of all, this appears to be increasing taxes, which I've said we wouldn't do. But a value-added tax actually gives a government a chance to blindfold the people and grow in stature and size. First of all, you are kind of interfering with one of the principal sources of local government levels and State governments in their use of the sales tax, since the Federal Government had so—you might say, confiscated the area of the income tax. But the other thing with that tax is, it's hidden in the price of a product. And that tax can quietly be increased, and all the people know is that the price went up, and they don't know whether the price went up because somebody got a raise, or whether the company wanted to increase profits, or whether it was government.

And I just am not enthused about it. I think I've said before, taxes should hurt in the sense that people should be able to see them and know what they're paying.

Subsequently, the idea took hold among conservatives that taxes should be raised in the most painful, inefficient manner possible so as to make it as difficult as possible to provide revenue for the government. This philosophy complimented another idea that had taken hold among conservatives in the late 1970s that tax cuts automatically led to spending cuts through a mechanism known as [starving-the-beast](#). Therefore, a poorly designed tax system and tax cuts whose sole purpose was to increase the deficit became the twin pillars of Republicans' tax policy. This was because, somehow or other, it would hold down the size of government, which they viewed as the one and only determinant of growth.

The conservative position on taxes is both wrongheaded and myopic in the extreme. It's wrongheaded because it ignores the fact that a poorly designed tax system imposes a heavy deadweight cost on the economy over and above the revenue raised. A 2005 [survey of research](#) on this subject by the U.S. Government Accountability Office found that the cost could be as high as 5 percent of Gross Domestic Product. It's myopic because most economists think that [technological innovation](#) plays a much bigger role in growth than the size of government. And it goes without saying that there is [not one iota of evidence](#) that starve-the-beast theory works; all it accomplishes is to increase the budget deficit, a fact just reconfirmed by a new [International Monetary Fund study](#).

Yet despite the obvious failure of [Republican tax policy](#) during the George W. Bush administration, Republicans are still as dogmatic as ever about opposing a VAT. Those that enforce the party line on taxes, therefore, responded to Daniels' mild support instantly and viciously. Dan Mitchell of the Cato Institute pronounced him unfit to be president in an October 15 [blog post](#). Grover Norquist of Americans for Tax Reform, chief enforcer of party discipline on taxes in the GOP, was even harsher. As he told [Politico](#):

This [Daniels' support of a VAT] is outside the bounds of acceptable modern Republican thought, and it is only the zone of extremely left-wing Democrats who publicly talk about those things ... Absent some explanation, such as large quantities of crystal meth, this is disqualifying. This is beyond the pale.

When a couple of commentators at National Review, a journal founded by conservative icon Bill Buckley, suggested that Daniels deserved some slack — he has not only been a successful Republican governor, but was Ronald Reagan’s White House political [director](#) and director of the Office of Management and Budget for George W. Bush — Norquist’s mouthpiece, Ryan Ellis, [struck back](#). He accused them of being sell-outs and insisted that any support for a VAT, even as a replacement for the entire tax system, is completely out of bounds.

Ellis further asserted that ATR alone sets the boundaries on tax issues for Republicans, just as the National Rifle Association establishes the limits of acceptable views on the gun issue. GOP money groups such as the Club for Growth follow ATR’s lead by, for example, refusing to support Republicans who won’t sign its [anti-tax pledge](#).

Of course, political partisans aren’t the only ones seeking to abort a VAT in the womb; special interests are also weighing in. The National Retail Federation, the principal trade association for the retailing industry, has also been active. On Oct. 13 it published a [study](#) warning that it would cost 850,000 jobs.

The truth of the matter is that there is no effort whatsoever underway to impose a VAT in the U.S. The hysterical response to Gov. Daniels — who has been mentioned as a possible presidential candidate in 2012 — is more about imposing orthodoxy on members of the Republican church lest they be tempted to actually do something meaningful to reduce the budget deficit they all claim to abhor, or accept that simply cutting taxes isn’t the only thing that will improve the tax system or reduce the size of government. Sadly, it will probably work. The cost of heresy is too high.

Note: I posted links to recent research on the VAT on [July 13](#) and [October 18](#).

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7 Comments

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pauldeba on Oct 22, 12:15 PM said:

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"the idea took hold among conservatives that taxes should be raised in the most painful, inefficient manner possible so as to make it as difficult as possible to provide revenue for the government. "

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That’s an odd way to say "transparency" and accountability to the people.

The liberal way I guess is the hypothetical frog boiling in the pot because you raise the temperature slowly rather than throwing him in the already boiling pot.

I prefer not to be boiled.

[Reply](#)

Brian on Oct 22, 12:18 PM said:

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So the assumption is that Grover Norquist somehow secretly runs the GOP? Or some other guy who most people have never heard of (yes, I know he’s a famous dude, but still most people have never heard of him). Right. Sure. Because as the last several months

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have demonstrated, the average Republican takes their marching orders from party bigshots and insiders. That's why Bob Bennett, Mike Castle, and Charlie Crist are cruising to election next month.

[Reply](#)

Tom C on Oct 22, 12:18 PM said:

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Government became 'unworkable' many years ago. Giving it more access to the resources of the productive economy is not a solution. The system is broken. Over-promising and under-delivering is what government does thus the concept of constitutionally LIMITED government. Without the constitution there is no law. We have been living without a constitution for 70 years or so.

[Reply](#)

Ghost_of_29 on Oct 22, 12:19 PM said:

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The GOP is a lot more interested in gaining power than it is in fixing the government's problems. All we ever hear from them is how obsessed they are about winning in November, and very little about what the game plan might be thereafter.

Republicans and Democrats are Tweedledee and Tweedledum. We all prefer one or the other, but what's the difference, really?

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Aqua Buddha on Oct 22, 12:20 PM said:

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Shhh! It's supposed to be a secret!

[Reply](#)

Patrick on Oct 22, 12:41 PM said:

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...."There was an extremely harsh and negative reaction, providing a good illustration of how Republicans enforce party discipline, create ideological rigidity, disdain rational debate, wallow in self-delusion, and consciously make government unworkable just to achieve partisan objectives".....

That will get people to listen to you Bruce! Oh that's right, that was never your intent to begin with. You are still working on your bona fides with your new buds, the Keynesians. Getting fired from the NCPA seems to have turned you into a bitter ender.

[Reply](#)

Buster Bunns on Oct 22, 12:42 PM said:

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Mitch Daniels is one of the few adults the Republicans have. As they will learn to their cost if they field a social conservative in 2012 instead of a fiscal one like Daniels. Fiscally conservative independents like me are watching the GOP carefully and are quite prepared to hold their feet to the fire by withholding our vote.

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