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Comment

VAT attack

Beware: 'Value-added tax' is an economy-killer

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One of President Obama's top economic advisers, former Fed chief **Paul Volcker**, sug gested this week that it's time for America to adopt a VAT, or value-added tax. The **White House** yesterday downplayed the idea -- but it's sure to resurface: It's an inevitable consequence of a government that's too big now and likely to grow even bigger thanks to Washington's reckless spending spree.

Don't get me wrong: The VAT -- on top of all the other taxes Washington imposes -- is a terrible idea. Imposing it would pretty well finish the transformation of our country into a European-style slow-growth nation. The right way to close Uncle Sam's gaping deficits is to reverse the continued explosion of federal spending.

Volcker: In pushing VAT, says what much of Washington is thinking.

The VAT is a type of national sales tax, levied on the value-added at each stage of production. Consider a piece of furniture: The VAT would be imposed when the raw timber is sold, when the sawmill produces lumber, when the manufacturer builds a chair, a tax at the wholesaler level and then when a retailer sells the chair to a consumer.

To avoid double taxation, each seller along the way gets a credit for taxes paid at earlier stages of the production process. So the final tax to the consumer, at least in theory, is the same as a retail sales tax of the same amount.

The VAT has its virtues: As a single-rate, consumption-based system, much like the flat tax or national sales tax, it would introduce far fewer economic distortions than today's income tax -- and a heckuva lot less paperwork.

That would be a persuasive argument -- *if* proponents wanted a VAT to replace the Internal Revenue code. But that's not what's intended by Volcker -- or **Senate Budget Committee** Chairman **Kent Conrad** and House Speaker **Nancy Pelosi**, who've also been chatting up the VAT.

The politicians want a VAT, and they want to keep the income tax. (To be more accurate, they want a VAT and to *raise* other taxes as well.)

They want the cash, of course, so they can continue buying votes by spending other people's money.

This decade already has seen a huge expansion of government. In the Bush years, federal spending rose from $1.8 trillion in 2001 to $3.5 trillion in the last Bush budget. Now **President Obama** is well on the way to doubling outlays yet again.

He has already saddled the economy with $800 billion of "stimulus" and a giant new health-care entitlement, and his proposals for next year will push the federal budget even higher.

Meanwhile, our aging population and the built-in growth in federal programs like Medicare, Medicaid and Social Security has a dramatic expansion in the size of government set to occur automatically in coming decades.

Simply stated, there's no way to finance all this new spending *without* an added broad-based tax. But this is exactly why we should vigorously resist a VAT.

Blocking a VAT may not be sufficient to control the size of government, but it's necessary. Handing Washington a whole new source of revenue would be akin to giving keys to a liquor store to a bunch of alcoholics.

The real-world evidence shows that VATs are strongly linked with both higher overall tax burdens and more government spending. In 1965, before the VAT swept across Europe, the average tax burden for advanced European economies (the EU-15) was 27.7 percent of economic output, versus 24.7 percent of GDP in the United States.

But the Europeans began imposing VATs in the late 1960s, and now the **European Union** requires all members to have a VAT of at least 15 percent. Good news has not followed. By 2006, the average tax burden for EU-15 nations had climbed to 39.8 percent, versus 28 percent in the United States.

The spending side? In 1965, pre-VAT, government spending in EU-15 nations averaged 30.1 percent of GDP, against 28.3 percent in the United States. By 2007, government spending consumed 47.1 percent of GDP in EU-15, significantly higher than the US burden of 35.3 percent.

Nor has the VAT stopped Europe from raising other taxes.

Taxes on income and profits consumed 8.8 percent of GDP in Europe in 1965 -- *below* the US level of 11.9 percent. By 2006, the European burden had climbed to 13.8 percent of GDP, slightly higher than the 13.5 percent US figure. (The same trend holds for corporate-tax data.)

Today's income-tax system is a nightmarish combination of class warfare and corrupt loopholes. But adding a VAT solves none of those problems, it merely gives politicians more money to spend and a chance to auction off a new set of tax breaks to interest groups. That's good for Washington, but bad for America.

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