

THE WALL STREET JOURNAL.

Will Republicans Hand the Left a VAT Victory?

Mitt Romney won't rule out the possibility of imposing a tax that's the fast track to a European welfare state.

By **DANIEL J. MITCHELL**

In a recent interview on these pages, presidential candidate Mitt Romney refused to rule out a value-added tax (VAT). He suggested that this hidden form of a national sales tax—which is embedded in the prices of goods and services during the production process—might be appropriate, particularly as a way of financing other tax cuts.

He's not the only Republican to speak favorably of a VAT. Herman Cain's 9-9-9 tax plan featured a flat tax and national sales tax. Very few people realized, however, that the final 9 was a VAT. And Rep. Paul Ryan, the chairman of the House Budget Committee and a favorite of the tea party thanks to his bold reforms to modernize Medicare and Medicaid, includes a VAT in his "Roadmap" plan, where it helps finance other reforms such as eliminating the corporate income tax.

What's going on here?

Most Republican supporters are drawn to the VAT for relatively benign reasons. It is a single-rate system, like the flat tax, for raising revenue, so it does not raise the possibility of class-warfare demagoguery. The VAT also doesn't hit savings and investment. And there are no distorting and corrupt loopholes. So there's a lot to like about the levy—or would be, if there were some practicable way of substituting a VAT for taxes on income.

Others assume that taxes eventually will be increased and they'd prefer to raise revenue in a less-destructive fashion. Better to impose a small VAT, the arguments go, than allow higher marginal tax rates on personal and corporate income to distort and discourage work effort and growth-enhancing investment.

These are legitimate motives, but it's important to look at what we can actually expect, not what some imagine in theory.

The most important thing to realize is that many people in Washington want bigger government, and a VAT is a necessary condition for that to happen. Simply stated, there is no way to turn America into a European-style welfare state without this new source of revenue.

But what about financing bigger government with higher income taxes, particularly on the wealthy? Though they'd never admit it publicly, smart left-wingers understand that there are two powerful reasons why soak-the-rich tax increases won't raise much revenue.

First, there aren't enough wealthy people to finance big government. According to IRS data from before the recession, when we had the most rich people with the most income, there were about 321,000 households with income greater than \$1 million, and they had aggregate taxable income of about \$1 trillion. That's a lot of money, but it wouldn't balance the budget even if the government confiscated every penny—and if it did, how much income do you suppose would be available in year two?

Second, higher tax rates don't raise as much revenue as expected. Upper-income individuals are far more likely to rely on interest, dividends and capital gains—and it is much easier to control the timing, level and composition of capital income, so as to avoid exposing it to the tax man.

This doesn't mean that those on the left won't push for class-warfare tax increases—they will. But their main motive will be politics, not raising revenue.

And that's why, looking at the long-run fiscal situation, the left needs a VAT. It's the only realistic way to collect the huge amount of revenue that will be necessary to finance the mountainous benefits promised by our entitlement programs. Which is exactly what happened in Europe, where welfare-state policies only became feasible after VATs were adopted, beginning in the late 1960s.

In this country, some manufacturers are willing to overlook the VAT's flaws because the tax is "border adjusted." This means that there is no VAT on exports, while the tax is imposed on imports. For mercantilists worried about trade deficits, this is a positive feature that they claim will put America on a "level playing field."

But that misunderstands how a VAT works. Under our current tax system, American goods sold in America don't pay a VAT—but neither do German-produced goods or Japanese-produced goods that are sold in America because their VAT tax is rebated on exports. Meanwhile, any American-produced goods sold in Germany or Japan are hit by a VAT, as are all other goods.

In other words, there already is a level playing field. To be sure, there will also be a level playing field if America adopts a VAT. But it won't make any difference to international trade. All that will happen is that the politicians in Washington will get more money whenever any products are sold.

Unsurprisingly, President Obama is favorably inclined toward a VAT, having recently claimed that it is "something that has worked for other countries." And yet it's unlikely that the president would propose a VAT, in large part because he is fixated on class-warfare tax hikes. If he did, almost every Republican in Congress would be opposed, even if only for partisan reasons.

But what if a VAT sympathizer like Mr. Romney wins next November and decides that his plan for a lower corporate tax rate is only possible if accompanied by a VAT? There will be quite a few Republicans who like that idea because they want to do something nice for their lobbyist friends in the business community. And there will be many Democrats drawn to the plan because they realize that they need this new source of revenue to enable bigger government.

That's a win-win deal for politicians and a terrible deal for taxpayers.

Mr. Mitchell is a senior fellow at the Cato Institute.