NATIONAL REVIEW

No to the Value-Added Tax

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November 13, 2015

Conservatives, libertarians, and other advocates of limited government have consistently argued that we should never allow Washington to have a broad-based consumption tax unless the 16th Amendment is first replaced by new language that makes it clear — even to John Roberts and Ruth Bader Ginsburg — that an income tax never again would be allowed to plague the nation.

But since there's no chance of that happening, at least we can take solace in the fact that politicians have been unable to impose big new sources of revenue. It's especially good news that the United States has resisted the value-added tax (VAT), which is tempting because of its revenue-generating capacity.

Europe's VAT Disaster Hostility to the VAT is justified by the European experience. Back in the mid 1960s, the burden of government spending in Europe was only slightly above the American level. But as VATs were implemented, the welfare state expanded, and now government consumes a much higher share of economic output on the other side of the Atlantic.

I suppose someone could argue that there was no relation between the adoption of VATs and the expansion of the welfare state, but that would be a monumental challenge for the simple reason that there's a limit to how much revenue can be generated by an income tax. As honest leftists will admit (at least off the record), the Laffer Curve is real. Politicians can increase tax rates on the "rich," but that doesn't mean more revenue, both because of overall economic weakness and because successful people will take steps to reduce their taxable income.

Indeed, income-tax revenues (personal *and* corporate) average less than 12 percent of GDP in OECD nations. And the small handful of countries that manage to collect substantially above that level impose very high tax rates at very low levels of income. Denmark, for instance, collects more money (as a share of GDP) from the income tax than any other nation, but not because there are dozens of billionaires paying huge amounts of money. Instead, regular workers lose 56 cents of every dollar they earn once their yearly income reaches about $62,000. Oh, and by the way, Denmark also has a 25 percent VAT, so the middle class not only pays onerous income taxes but also gets pillaged by a VAT.

In other words, the only effective way to finance European-sized government is to have European-style taxation. Which is exactly why the Left desperately wants a VAT.

A VAT of Trouble

This sobering evidence notwithstanding, some conservatives think the VAT is an acceptable risk if it's part of a bigger tax-reform plan. Senators Rand Paul and Ted Cruz, for instance, both have proposals that would lower personal-income-tax rates, reduce double taxation of income that is saved and invested, and eliminate corporate income taxes and payroll taxes.

But there's a catch. While both candidates properly want the IRS to collect less revenue, the aforementioned pro-growth provisions would dramatically reduce tax receipts even when we use dynamic scoring. So Paul and Cruz would offset some of the revenue loss by imposing VATs.

On paper, these plans would be very good for the economy. But something that looks pretty on a blackboard might not be so appealing once you add the sordid reality of politics to the equation. To be blunt, unless there's a magic guarantee that principled conservatives such as Rand Paul and Ted Cruz (and their philosophical clones) would always hold the presidency, a VAT would be a very risky gamble.

Downside Risk

To understand, let's do a thought experiment. Imagine that either Paul or Cruz wins the 2016 election and we get their version of tax reform. That would be good news for the American economy, with faster growth and enhanced competitiveness. But only in the short run. What happens in the future when a statist wins the White House?

We know that will happen at some point, so consider the possible consequences. That politician (President Chelsea Clinton?) will want a big increase in the tax burden to help financing an ever-growing budget. If we had something akin to our current tax code, she would have three unpleasant options: impose class-warfare tax increases, which wouldn't actually generate much revenue; impose much higher tax rates on lower-income and middle-income taxpayers, which would be very unpopular; or convince Congress to adopt a VAT, which also would be very unpopular.

But what if the VAT already exists thanks to well-meaning but misguided Republicans? Raising the VAT rate would be a comparatively simple option for our hypothetical left-wing president. And because it has such a broad tax base (all "value added" in the economy, including wages paid to workers), even small rate increase would generate a lot of revenue to finance bigger government. Moreover, because the VAT is a hidden tax that is collected by businesses, the workers and consumers who would pay the additional tax typically would not realize that government was to blame as their living standards declined. And I'm sure this future statist president also would boost tax rates on the "rich" and also impose higher levels of double taxation.

By the way, there's a downside risk to other types of tax reform. But it's a matter of magnitude. If we did something like Ben Carson's flat tax or the more incremental tax-reform plans of Jeb Bush and Marco Rubio, it's obviously possible for a future leftist to undo those reforms, in which case we could degenerate back to the current system.

That's obviously bad news, but it's not nearly as bad as what might happen with the Cruz and Paul plans. When the wrong politicians got back in charge, they'd restore all the bad features of the income tax and also use the VAT as a money machine to expand the welfare state. And when the dust settles, we'd be France.

Rebutting the Rebuttal

Steve Moore recently defended the VAT on these pages. He made many good points about the pro-growth features of the proposals put forth by Paul and Cruz. But as noted above, there's no disagreement on that point. Both senators have plans that are far better than the current system. And if we had some way to ensure that leftists never again would be in control, their proposals would be worthy of very strong support.

So the real question is whether there's a way to guard against the downside risks outlined above. Let's see if Steve makes a compelling argument.

He pointed out in his column that "wages and salaries are taxed at a low flat rate" with the Paul and Cruz plans. That's true, but it doesn't address my concerns about what will happen in the future under a left-wing president.

Steve's strongest point is that he's not really arguing for an additional tax, because the payroll tax would be abolished. That's a fair point, but that doesn't mean it's a good trade. Simply stated, the VAT generates far more money. It would be akin to giving the Left a more powerful vacuum with which to extract money from the economy's productive sector. Moreover, getting rid of the payroll tax would probably kill any chance of reforming Social Security.

Let's look at Steve's other arguments. He writes that "we need to find ways to make the tax more visible to consumers." That's a noble sentiment, I guess, but VATs are inherently hidden taxes. And even if you mandate that the VAT somehow is visible (a notice stating that your paycheck has been reduced by 14.5 percent or 16 percent?), that doesn't address the big concern about its risk.

He acknowledges that a VAT means "politicians will start increasing rates by a point or two at a time to raise a vault of dollars to fund more government programs." He then follows that sentence by asserting that "the same danger arises under every flat-tax plan." But that's not the case. As explained above, the risk of a flat tax is that we eventually return to the mess we have now. The risk of an add-on VAT, by contrast, is that we become France.

Steve also has at least one glaring mistake in his column. He wrote that "a Steve Forbes/Dick Armey flat tax … also replaces the corporate tax with a form of VAT." That's not true. The defining characteristic of a VAT is that wages are non-deductible to employers, which is just a wonky way of saying that employers have to pay a VAT on any compensation they give to workers. But under the flat tax, wages are deductible, which means there's no hidden tax on wages and salaries.

It's also disappointing that Steve makes a quasi-protectionist argument for the VAT. He wrote that "our current tax system perversely taxes what we produce, but not what we import. That's dumb policy." But Steve's attempt to lure Trump voters is based on a false assumption, since a VAT does not disproportionately penalize goods from overseas. Under current law, there's no VAT on any products sold in America, regardless of whether they're produced domestically or overseas. And if we have a VAT, that new tax would be levied equally on all "valued added," regardless of whether goods are produced in America or in other countries. All that changes is that Washington gets more money.

The final point worth mentioning is that Steve writes that “there are probably about a dozen different ways to craft a flat tax, everything from the 9-9-9 plan devised by Herman Cain to the national sales tax to the Paul and Cruz plans. They are variations on the same theme.” He’s right, at least in the sense that there are several ways to design a tax code that has no double taxation while also taxing economic activity at a flat rate. He’s also partially right that “conservatives should be for whichever one of them is politically most salable and can pass.”

But he’s only partially correct. We also should make sure we’re not for a plan that inadvertently gives the other side a revenue machine to expand the burden of government spending. Advocates of statism are salivating for a VAT. It would truly be tragic if they get that awful new tax because of Republicans.

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