VAT, Other Revenue Raisers Touted as Vital for Tax Reform

By David van den Berg — dvandenb@tax.org

Revenue should be raised as part of any broad tax reform package, speakers said at an October 26 tax policy conference in New Orleans.

William Gale, co-director of the Urban-Brookings Tax Policy Center, said a VAT could accomplish that. “In terms of revenue, if Willie Sutton were a public finance economist, he would study the VAT,” Gale said, referring to the 1930s criminal who reportedly said he robbed banks “because that’s where the money is.” “The VAT is where the money is,” Gale added.

Gale said that as a consumption tax, the VAT combines a lump sum tax on all capital with a tax on current and future wages. Gale said that according to his calculations, a 10 percent VAT — with a demogrant given to all households to offset consumption up to the federal poverty line and a fairly broad base as defined by the Congressional Budget Office, and accounting for reductions in other taxes because of the VAT’s creation — would net about 2 percent of GDP in revenue.

However, the country doesn’t have the luxury of replacing the income tax with a VAT, as was discussed in the 1990s, Gale said. “I could see using some of the VAT revenues to reduce aspects of the income tax, but I don’t see how we get rid of the income tax,” he said.

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The conference, hosted by Tulane University’s Murphy Institute and Department of Economics, explored tensions between the need for a tax system that would provide enough revenue to deal with long-term budget challenges, promote economic growth in the long term, and be progressive in the face of growing inequality, according to the university’s economics department.

Alan Viard of the American Enterprise Institute said a conventional VAT would not maintain progressivity. He argued for the complete replacement of the income tax with progressive consumption taxation. He suggested that one possible solution could be a hybrid of a personal expenditure tax and an X tax, a type of progressive consumption tax originally devised by the late economist David Bradford under which businesses are taxed on gross receipts minus wages and employees are taxed progressively on those wages. (For prior coverage, see Tax Notes, June 11, 2012, p. 1332, Doc 2012-12046, or 2012 TNT 108-2.)

Political challenges aside, moving to progressive consumption taxation “would completely avoid the income tax’s saving penalty, its distortions across assets, and also the complexities of income accounting,” Viard said. “Now, obviously the different add-on and partial replacement options we’ve seen would have gains of this kind as well, but not as large because they would be partial replacements rather than complete replacements,” he added.

Leonard Burman of Syracuse University proposed something he said doesn’t go as far: earmarking a VAT as a funding source for Medicare and Medicaid programs. That could allow for lowering income tax rates, he said.

Other would-be tax reformers have proposed repealing or limiting tax expenditures to help raise revenue and lower rates, but Burman said cutting tax expenditures could be a tough sell politically. “There’s a lot of money there, and it’s really hard to figure out how you can get people to give these things up,” he said.

One possible alternative to cutting tax expenditures would be to cap deductions at a specific dollar value, as Republican presidential nominee Mitt Romney has proposed. (For prior coverage, see Tax Notes, Oct. 22, 2012, p. 359. For prior analysis, see Tax Notes, Oct. 15, 2012, p. 227, Doc 2012-20957, or 2012 TNT 196-1.)

But Burman said the idea of capping deductions would be a tough sell, too. “It’s kind of a clever idea, assuming that people don’t really pay much attention,” he said. “If people do pay attention, they’ll actually notice that they’re actually losing the value of all their tax expenditures, and they might object to that.”

Raising corporate taxes is not a possibility, Burman said. “One of the things that made the Tax Reform Act of 1986 work was that there was another source of revenue that could be used to cut individual income tax rates,” he said. “We’re not going to be able to raise corporate income taxes again — arguably we should be cutting those.”

James Alm, an economics professor and chair of the Economics Department at Tulane, suggested that the prospects for a sweeping tax reform package like the 1986 act seem remote. Three conditions must be met for a tax reform effort to happen, he said. First, the tax system must be seen by most relevant players as significantly broken, and second, there must be a consensus on how to fix it. Third, there must be a “strong champion” who can generate political support for tax reform.
While there may now be a consensus that the tax system is broken, there is no consensus about what should be done, Alm said. “The perfect storm, I think, that surrounded the Tax Reform Act of ’86 that led to its implementation is not there,” he said.

However, Diane Lim Rogers, chief economist at the Concord Coalition, argued that the country’s fiscal outlook may nonetheless force tax reform to happen. In 1986 Congress could choose not to do tax reform, she said, but today there are not many avenues available to deficit reduction other than tax reform.

“The only way we’re going to get to economically sustainable deficits is to raise revenues as a share of GDP,” she said.

Rogers said the federal government should allow the 2001 and 2003 tax cuts to expire, and then it should work to achieve the same amount of deficit reduction over the 10-year window as would come from the spending cuts and tax increases scheduled to result under the so-called fiscal cliff. “I believe that the current-law baseline is still a realistic 10-year budget target,” she said.

Rogers said that simply letting the Bush tax cuts expire might be more achievable politically than other tax reform proposals. “I feel like that’s the easiest thing to get done, considering where we’ve been the last decade and the reality of what Congress is in the mood for,” she said.

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**CRS Pulls Report on Tax Rates and Economic Growth**

The nonpartisan Congressional Research Service has removed from distribution a report analyzing the relationship between tax rates and economic growth following objections to the report raised by Senate Republicans.

The report, “Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945,” concluded that changes in the top income tax and capital gains rates do not appear to be correlated with economic growth, contrary to the argument made by Republicans that reducing tax rates increases savings, investment, and productivity. (For the report, see Doc 2012-19408 or 2012 TNT 181-33.)

CRS spokeswoman Janine D’Addario told Tax Analysts that CRS management decided to put the report “into non-distributional status pending update.” D’Addario said that any communication between the CRS and members of Congress was confidential but that to her knowledge, the “CRS has never withdrawn a product based solely on” a request by lawmakers.

The report’s author, Thomas L. Hungerford, said he stands behind the report.

The CRS prepares its reports analyzing policy and legislation for members of Congress and their staffs. The reports are normally available on areas of the CRS website that are accessible primarily via the Capitol intranet.

Senate Finance Committee Republican spokeswoman Antonia H. Ferrier told Tax Analysts that the report’s conclusions were “highly questionable” and that the CRS took down the report after Republican staff members “shared a litany of concerns with CRS over the methodology, the analysis, and the conclusions.” The New York Times first reported that the report had been pulled in September following complaints by Senate Minority Leader Mitch McConnell, R-Ky., and other Senate Republicans.

House Ways and Means Committee ranking minority member Sander M. Levin, D-Mich., on November 1 sent a letter to CRS Director Mary B. Mazanec requesting an explanation for the report’s removal.

“I was deeply disturbed to hear that Mr. Hungerford’s report was taken down in response to political pressure from Congressional Republicans who had ideological objections to the report’s factual findings and conclusion,” Levin said in the letter. “It would be completely inappropriate for CRS to censor one of its analysts simply because participants in the political process found his or her conclusion in conflict with their partisan position.” (For the letter, see Doc 2012-22571 or 2012 TNT 213-15.)

Curtis Dubay of the Heritage Foundation said in a September blog post that the report “called into question the quality of CRS analysis and the institution’s credibility as non-partisan.” The report took too simplistic a view of the economy, he said. “For the analysis to prove anything, it needed to account for countless other economic and policy factors, many specific to a given period, and determine how those factors influenced economic growth in the period in question,” he said. (For the post, see Doc 2012-19406 or 2012 TNT 181-40.)

— Eric Kroh