

# Once Considered Unthinkable, U.S. Sales Tax Gets Fresh Look

Levy Viewed as Way to Reduce Deficits, Fund Health Reform

By Lori Montgomery  
Washington Post Staff Writer  
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With budget deficits soaring and President Obama pushing a trillion-dollar-plus expansion of health coverage, some Washington policymakers are taking a fresh look at a money-making idea long considered politically taboo: a national sales tax.

Common around the world, including in Europe, such a tax -- called a value-added tax, or VAT -- has not been seriously considered in the United States. But advocates say few other options can generate the kind of money the nation will need to avert fiscal calamity.

At a White House conference earlier this year on the government's budget problems, a roomful of tax experts pleaded with Treasury Secretary Timothy F. Geithner to consider a VAT. A recent flurry of books and papers on the subject is attracting genuine, if furtive, interest in Congress. And last month, after wrestling with the White House over the massive deficits projected under Obama's policies, the chairman of the Senate Budget Committee declared that a VAT should be part of the debate.

"There is a growing awareness of the need for fundamental tax reform," Sen. Kent Conrad (D-N.D.) said in an interview. "I think a VAT and a high-end income tax have got to be on the table."

A VAT is a tax on the transfer of goods and services that ultimately is borne by the consumer. Highly visible, it would increase the cost of just about everything, from a carton of eggs to a visit with a lawyer. It is also hugely regressive, falling heavily on the poor. But VAT advocates say those negatives could be offset by using the proceeds to pay for health care for every American -- a tangible benefit that would be highly valuable to low-income families.

Liberals dispute that notion. "You could pay for it regressively and have people at the bottom come out better off -- maybe. Or you could pay for it progressively and they'd come out a lot better off," said Bob McIntyre, director of the nonprofit Citizens for Tax Justice, which has a health financing plan that targets corporations and the rich.

A White House official said a VAT is "unlikely to be in the mix" as a means to pay for health-care reform. "While we do not want to rule any credible idea in or out as we discuss the way forward with Congress, the VAT tax, in particular, is popular with academics but highly controversial with policymakers," said Kenneth Baer, a spokesman for White House Budget Director Peter Orszag.

Still, Orszag has hired a prominent VAT advocate to advise him on health care: Ezekiel Emanuel, brother of White House chief of staff Rahm Emanuel and author of the 2008 book

"Health Care, Guaranteed." Meanwhile, former Federal Reserve chairman Paul A. Volcker, chairman of a task force Obama assigned to study the tax system, has expressed at least tentative support for a VAT.

"Everybody who understands our long-term budget problems understands we're going to need a new source of revenue, and a VAT is an obvious candidate," said Leonard Burman, co-director of the Tax Policy Center, a joint project of the Urban Institute and the Brookings Institution, who testified on Capitol Hill this month about his own VAT plan. "It's common to the rest of the world, and we don't have it."

### **Seeking New Revenue**

The surge of interest in a VAT is testament to the extraordinary depth of the nation's money troubles. While some conservatives have long argued that a consumption tax would provide a simpler and more efficient alternative to the byzantine U.S. income tax code, this time it's all about the money.

The federal budget deficit is projected to approach \$1.3 trillion next year, the highest ever except for this year, when the deficit is forecast to exceed \$1.8 trillion. The Treasury is borrowing 46 cents of every dollar it spends, largely from China and other foreign creditors, who are growing increasingly uneasy about the security of their investments. Unless Congress comes up with some serious cash, expanding the nation's health-care system will only add to the problem.

Obama wants to raise income taxes for high earners and impose new levies on business, but those moves would not generate enough cash to cover the cost of health care, much less balance the budget, and they have not been fully embraced by Congress. Obama's plan to tax greenhouse-gas emissions could raise trillions of dollars, but again, Congress is balking.

Key lawmakers are considering other ways to pay for health reform, including new taxes on sugary soda, alcohol and employer-provided health insurance. The last proposal could raise a lot of money -- nearly \$1 trillion over the next five years, according to White House budget documents. But options on the table would raise a fraction of that sum. And while it might pay for health care, it would barely dent deficits projected to total nearly \$4 trillion over the next five years and to grow rapidly in the future, as baby boomers draw on Social Security and Medicare.

Enter the VAT, one of the world's most popular taxes, in use in more than 130 countries. Among industrialized nations, rates range from 5 percent in Japan to 25 percent in Hungary and in parts of Scandinavia. A 21 percent VAT has permitted Ireland to attract investment by lowering its corporate tax rate.

The VAT has advantages: Because producers, wholesalers and retailers are each required to record their transactions and pay a portion of the VAT, the tax is hard to dodge. It punishes spending rather than savings, which the administration hopes to encourage. And the threat of a VAT could pull the country out of recession, some economists argue, by hurrying consumers to the mall before the tax hits.

## **A VAT's Bottom Line**

What would it cost? Emanuel argues in his book that a 10 percent VAT would pay for every American not entitled to Medicare or Medicaid to enroll in a health plan with no deductibles and minimal copayments. In his 2008 book, "100 Million Unnecessary Returns," Yale law professor Michael J. Graetz estimates that a VAT of 10 to 14 percent would raise enough money to exempt families earning less than \$100,000 -- about 90 percent of households -- from the income tax and would lower rates for everyone else.

And in a paper published last month in the Virginia Tax Review, Burman suggests that a 25 percent VAT could do it all: Pay for health-care reform, balance the federal budget and exempt millions of families from the income tax while slashing the top rate to 25 percent. A gallon of milk would jump from \$3.69 to \$4.61, and a \$5,000 bathroom renovation would suddenly cost \$6,250, but the nation's debt would stabilize and everybody could see a doctor.

## **Sales Tax Gains Momentum**

Burman, who helped House Democrats craft an unsuccessful 2007 plan to repeal the alternative minimum tax, said he's received a number of phone calls from lawmakers interested in his idea, though "they can't quite imagine how to make it happen politically." Burman said the 25 percent rate has caused some sticker shock, and he's trying to figure out how to bring it down.

Graetz's proposal drew an endorsement from Volcker, who last year called it "a sensible plan for reform." (Volcker did not respond to a request for comment.) It also has piqued the interest of Conrad, the Senate Budget Committee chairman who argues that it could be modified to accommodate Obama's pledge not to raise taxes on families who make less than \$200,000 a year.

"I think interest is quietly picking up," Graetz said. "People are beginning to recognize that the mathematics of the current system are just unsustainable. You have to do something. And a VAT has got to be on the table if you want to do something big and serious."

Still, the Senate Finance Committee declined to include a VAT among the options it is considering to pay for health reform. And even VAT supporters doubt the tax will find a place among the tax-reform proposals the Volcker panel has been asked to produce by Dec. 4.

Though the nation's fiscal outlook is grim, Burman said "the situation will have to get more desperate" before lawmakers are likely to consider a new levy aimed directly at the pocketbooks of every one of their constituents.

Most lawmakers are still looking for "a painless source of revenue" to overhaul the health-care system and dig the nation out of debt, Burman said. "Who knows?" he added. "Maybe the tooth fairy will bring that to them."