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Briefing

**The pros and cons of VAT**  
**A last resort**

Nov 19th 2009  
From *The Economist* print edition

**Its advantages are oversold, but it is gaining adherents**

LIBERALS oppose a value-added tax because it falls more heavily on the poor. Conservatives oppose it because it is a money machine. Larry Summers, Barack Obama's chief economic adviser, once predicted that America would get a VAT when the two sides reversed positions. That moment may be approaching. Several prominent liberals and a handful of conservatives now see it as the most promising way to raise revenue, reduce the deficit and make the tax system more efficient.

VAT is a tax on consumption rather than income. All 30 members of the OECD levy one, save America. Unlike state sales taxes, which are charged only to the final customer, VAT is levied at each stage of production. This boosts compliance because a business, to receive credit for VAT paid on its inputs, must usually collect VAT on what it sells. VAT is usually charged at the same rate on almost everything. It thus distorts economic decisions less than an income tax, which is charged at varying rates with numerous exemptions.

Its advantages, however, are less overwhelming than they seem. Noncompliance for VAT ranges from 4% to 17.5% of tax owed, according to the OECD, not very different from the 14% estimated for America's income tax. Politically sensitive categories are often exempted or taxed at a lower rate, diluting efficiency: child care in Australia, groceries in Canada, food and children's clothing in Britain.

In America, a federal VAT would be imposed on top of the retail-sales tax charged by 45 states. Some could gain efficiency (and money) by harmonising their sales taxes with a federal VAT; four out of ten provinces already do so in Canada. An advisory commission recently recommended that California should adopt a VAT-like tax. It would be much more efficient if it piggybacked on a federal VAT, says Charles McLure of the Hoover Institution, a think-tank.

Selling a VAT is politically tricky. Australia, Canada and New Zealand, all recent VAT-adopters, replaced an existing federal consumption tax. Americans would be asked to pay a brand-new tax. The solution might be to charge a high enough VAT to exempt most Americans from income tax. That way, Mr Obama could claim he had kept his promise not to raise taxes on any household earning less than \$250,000.

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