## EUROPE'S FATAL AFFAIR WITH VAT

(from page 6)

means reformers should extend the reach of the tax, as the EU does with its push for tax "harmonization" among member nations.

Thus, Buchanan and Flowers wrote "If the tax is uniformly imposed on the sale of all commodities and services, there can be no real shifting of resources from taxed employments to nontaxed employments. The shift in relative prices occasioned by the partial tax cannot occur under a truly general sales tax" (1975, p. 399). Even Harry G. Brown, no fan of sales taxes, wrote "if there is a tax on the production of all commodities and services ... there is no advantage in leaving one taxed line for another line which is taxed to the same extent." (1939, p.254). Earl Rolph and George Break commit to this view (p.117). So does Harold Somers (pp. 17, 26). Bernard Herber (p.254) and David Hyman (2005 pp.617-26) chime in cautiously. Charles McLure wrote that proponents (he being one) expect VAT to "free the economy from distortions resulting from present taxes. ... . "Neutrality is one of the chief advantages of the tax on value-added." He also damns "... the ridiculously unfair and distortionary de facto exemption of interstate sales ..." (2005). Harold Somers' writes that a tax on gross sales is the same as a tax on net income (p.27). We return to this later, under "The Mill Effect".

All the above quotes refer only to taxes on simple "commodities", conceived and defined and illustrated in the most simple-minded ways. The writer has compiled a long list of loopholes, too simple and common to repeat here (Gaffney, xxxx). The greatest is the explicit exemption of all sales involving real estate. State sales tax laws in the U.S.A. all specify sales of PERSONAL property only, thus excluding from the start sales and rentals of homes, associated curtilages and demesnes, recreational and scenic holdings, etc. Unearned increments (aka capital gains) from most such lands are untaxed. Interest secured by mortgages is untaxed, and so on.

Capital proper, when affixed to land, becomes "real estate", hence exempt from sales taxes (and, I presume, most European VATs, although "no two VATs look exactly alike" (James, p.18)). The most durable forms of capital, the kinds that Austrians believe are oversupplied, are affixed to land, hence exempt from VATs.

Modern writers deplore the exemption of "services" from the sales tax base. These writers and teachers refer in their contexts only to labor services, ignoring the service flows of land or capital. This is not from ignorance: they know that the "service-flow" of an owner's home has long been included in NIPA as a form of income, income consumed by the owner-occupant as the real estate yields it. They just blank that out when it comes to taxing services to the "final" consumer (Anderson, p.252).

John Stuart Mill in 1848 looked deeper, in a proto-Austrian way, and pointed out a systemic bias inherent in the tax. I repeat his quote here, for emphasis.

*".. if there were a tax on all commodities, exactly proportioned to their value, there would, ..... as Mr. M'Culloch has pointed out, be a 'disturbance' of values,... owing to ... the different durability of the capital employed in different occupations. ... in two different occupations ... if a greater proportion of one than of the other is fixed capital, or if that fixed capital is more durable, there will be a less consumption of capital in the year, and less will be required to replace it, so that the profit, if absolutely the same, will form a greater proportion of the annual returns. To derive from a capital of £1,000 a profit of £100, the one producer may have to sell produce to the value of £1,100, the other only to the value of £500. (I.e., where capital is less durable, you must sell more gross to get the same net profit.)*

*If on these two branches of industry a tax be imposed ... the one commodity must rise in price, or the other must fall, or both: commodities made chiefly by immediate labor must rise in value, as compared with those which are chiefly made by machinery. ... " -- (1848, Book V, Chapter IV, pp. 504-05).*

Mill hid this light under a bushel, by offering just one example of a small difference, arithmetic only. It is easy to overlook in passing, and standard-brand economists have done so. So, tragically, have most Austrian writers, few of whom analyze tax policy. Their strong tendency is to impute the malallocation of capital solely to misguided central bank policies, blanking out other factors like tax policy. We should, rather, set Mill's light in a tower on a hilltop as a beacon sending its gleam across the wave to save the foundering ship of state.

Harold Groves, a clearer expositor than Mill, makes the point in a simple table (p.113). "Store A is engaged in a trade which has a very slow turnover, such as the furniture business; Store B is one with a rapid turnover, perhaps a meat shop".

| | I | II | III | IV | V | IV |
|---|---|---|---|---|---|---|
| Store | Operating Capital | Gross Sales | Sales / Capital | Profit Before Tax | Tax @.5% | Tax/ Capital 0% |
| A | $30,000 | $30,000 | 1 | $300 | $150 | 0.5 |
| B | 2,000 | 100,000 | 50 | 200 | 500 | 25.0 |

The sales tax is based on Column (II). It gathers much more from B, the meat shop, than from A, the furniture store, because of B's higher turnover and greater volume. B's little capital of $2,000 turns over 50 times and is taxed 50 times a year, while A's $30,000 turns over and is taxed just once. Groves uses this table for another purpose, but it serves to make Mill's point as well.

Again, compare a parking lot with a cafeteria. Suppose both to be taxed on gross sales, including services. The inventory of fresh food in the cafeteria is taxed daily, as it sells out and turns over. The payrolls (continued on page 8)