

# The New York Times

April 6, 2005

## Feed the Beast

By **Bruce Bartlett.**

GROWING numbers of policy analysts and politicians are saying that it may finally be time to consider a value-added tax as part of our federal revenue system. In years past, I would have been in the forefront of those denouncing the idea. But now, reluctantly, I have joined the pro-V.A.T. side. Here's why.

There are many arguments against a value-added tax, which is essentially a sales tax that applies at each stage of production. It is costly to put into effect, and it hits the poor and the elderly hardest because they spend a higher percentage of their income.

When the idea of a value-added tax for the United States first arose during the Nixon administration, there was no question that it would have fueled the growth of government, just as it did in Europe. As a recent Wall Street Journal editorial pointed out, in the countries that established a V.A.T. in the 1960's and early 1970's, taxes as a share of the gross domestic product have risen significantly.

But the main reason for this is that it was too easy to raise V.A.T. rates amid the double-

digit price increases of the inflationary 1970's. In those days, there were many economists who still believed that budget deficits caused inflation, making it easier to delude people into thinking that higher taxes were necessary to get inflation under control.

Those countries that adopted the value-added tax since the end of the great inflation, however, have been very restrained in raising rates. Of those countries that had a V.A.T. before 1974, all have raised their rates by an average of seven percentage points. But of those countries that established a V.A.T. since 1974, the average increase is just one percentage point, and a majority have not increased their rates at all.

In the 1980's and 1990's, I thought it was possible to restrain the growth of government by cutting taxes. This would "starve the beast," as Ronald Reagan used to say, and force government to live on its allowance. And after Republicans got control of Congress in 1994, I thought the means had finally come to make a frontal assault on the welfare state.

I have been sadly disappointed. After an initial effort at restraining Medicare spending -- squelched by President Bill Clinton's veto pen -- Republicans in Congress have become almost indistinguishable from Democrats on spending. They have been aided and abetted by President Bush, who not only refuses to veto anything, but also aggressively worked to ram a \$23.5 trillion (of which \$18.2 trillion must be covered by the general revenue) expansion of Medicare down the throats of the few small government conservatives left in the House.

This behavior has led me and other conservatives to conclude that starving the beast simply doesn't work anymore. Deficits are no longer a barrier to greater government spending. And with the baby-boom generation aging, spending is set to explode in coming years even if no new government programs are enacted.

As Alan Greenspan, chairman of the Federal Reserve, told the House Budget Committee on March 2, "The combination of an aging population and the

soaring costs of its medical care is certain to place enormous demands on our nation's resources and to exert pressure on the budget that economic growth alone is unlikely to eliminate."

Yet many conservatives continue to delude themselves that all we have to do is cut foreign aid and get rid of pork barrel projects to rein in the budget. But unless health spending is confronted head on, even the most draconian cuts in discretionary spending won't be enough to restore fiscal balance.

I am no deficit hawk. For decades I have argued that the negative effects of deficits are generally exaggerated. But unless spending is checked or revenue raised, we are facing deficits of historic proportions. It is simply unrealistic to think we can finance a 50 percent increase in spending as a share of gross domestic product -- which is what is in the pipeline -- just by running ever-larger deficits. Sooner or later, that bubble is going to burst and there will be overwhelming political support for deficit reduction, as there was in the 1980's and early 1990's.

When that day comes, huge tax increases are inevitable because no one has the guts to seriously cut health spending. Therefore, the only question is how will the revenue be raised: in a smart way that

preserves incentives and reduces growth as little as possible, or stupidly by raising marginal tax rates and making everything bad in our tax code worse?

If the first route is chosen, the value-added tax is by far the best option available to deal with an unpalatable situation. Absent any evidence that the White House and Congress are prepared to restrain out-of-control health spending, I see no alternative.