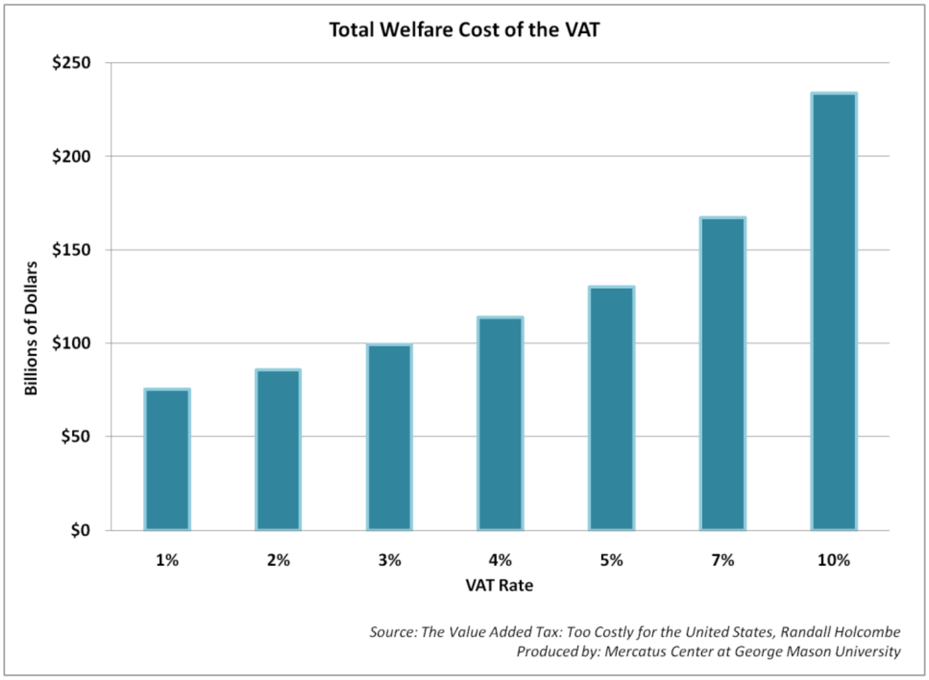

Mercatus Center Senior Research Fellow Veronique de Rugy examines the true cost to the economy of instituting a Value Added Tax (VAT) using data from University of Florida's Randall Holcombe.

The VAT is a consumption tax levied on a product at each stage of production based on the value added to the product at that stage. While hailed by economists for its lack of distortionary economic effects, the VAT still imposes greater costs on society than simply the revenue that it collects. In the case of the United States, these costs would be even greater than those associated with the VAT in the EU or the costs associated with current income and sales taxes. These increased costs arise from the nature of the tax: computing tax owed under the VAT is more complex than under sales or income taxes and the proposed VAT will supplement the existing tax system, and is not likely to accompany an overhaul in existing taxes.

The above graph illustrates Randall Holcombe's estimates of the *economic costs* of the VAT – the total of deadweight loss, compliance and administrative costs. These net costs range from $75.5 billion dollars for a 1% VAT to $233.8 billion dollars for a 10% VAT. Take these figures in context; the revenue raised from a 1% VAT would be $77.9 billion dollars (or *96.9%* of the total of deadweight, compliance, and administrative costs required to implement it). As the rate of the tax increases, the ratio of revenue to deadweight costs decreases; the revenue raised from a 10% VAT would be $708.4 billion dollars (or 33% of deadweight, compliance, and administrative costs). The true cost of any VAT that would be implemented is substantially greater than the value of the tax revenue itself and this cost should be carefully considered.

Note that none of the tax rates cited above would generate nearly enough revenue to balance the budget.

Veronique de Rugy explains why instituting a VAT is the wrong policy.

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