Using VAT for Jobs, Health and Retirement

The media debate about VAT has missed the mark. Strategically employed, VAT can legally promote and protect domestic production of anything mined, made, grown or serviced in any country. The question is not whether we have new taxes, high taxes or low taxes. The question is whether we have smart or dumb taxes in relation to promoting economic growth and international competitiveness.

VAT is a valuable tool used by 153 countries to gain a competitive edge in trade with the USA.

Americans simply look at VAT as a Value Added Tax on goods and services at each stage of production. In this narrow view, VAT is a consumption tax that is regressive. Overlooked is the strategic importance of VAT to international trade, domestic jobs and real wages if used intelligently.

The VAT becomes just like a tariff when the proceeds are used to subsidize production in any country competing with another. The average VAT worldwide is about 16%. The proceeds of VAT can be used like any tax in many ways. One way is to fund health care costs. This remains true whether or not the nation's health care system is socialized or private.

Let's look at a real world example of how this impacts my company---Revere Copper Products. Revere fabricates copper and brass products for further manufacturing and for building and construction markets. Revere has a health care plan for its employee owners. Imagine Revere workers on the factory floor producing a coil of copper. The price Revere sells it for must cover their wages and salaries plus the cost of metal, energy, equipment, materials and supplies as well as taxes and their own health care costs. When that Revere product is shipped abroad, the foreign country applies a VAT. Some of the proceeds of that VAT are used to help pay for the health care cost of the citizens of that country, not ours.

In order to compete globally, my workers must produce at a cost that pays for their own health care costs and the costs of the workers in the foreign factory they are competing against.

The US Social Security retirement system works in much the same way. Although US producers match the employee contribution, the US producer pays for it all as the employee's contribution is simply deducted from compensation. Again, US workers must produce at a cost that also covers their retirement when that coil of copper is sold.

When the USA negotiates a Free Trade Agreement with another country, both are required to reduce tariffs. VATs and other border adjustable taxes are not considered "tariffs" even though they act as tariffs in reality. The foreign countries tax our goods to pay for their domestic programs. Canada and Mexico are good examples. Around the period of the negotiations for NAFTA, both Canada and Mexico dramatically increased such taxes which then offset much of their agreed upon reduction of other tariffs. The result was that the U.S. lowered import charges but they did not.

Europe and the rest of the world have also lowered tariffs as we did but increased VAT so their import charges are unchanged. They are tradewise and strategically smart; we are not.

In order for VAT to be compliant with World Trade Organization (WTO) rules, the VAT is applied by other countries to their domestic production as well as imports. But the VAT cost is largely offset for their domestic production by subsidies financed by VAT for health care, retirement, taxes, etc. that US producers do not receive. US producers pay taxes but do not receive these countervailing subsidies. We are not competitive as a result.

VAT also promotes exports. When a product is exported, the VAT is not applied. This means exported products are sold relatively tax free. That's because producers in foreign countries still benefit from the same health care, retirement and other subsidies even though no VAT was collected for exports. Thus, while export subsidies are largely banned by the WTO, the VAT rebates accomplish the same thing.

Exports from other countries benefit from subsidies provided by VAT yet still have the average 16% VAT deducted from their full value.

So how can we compete through a smart tax strategy? Let's again look at a real world example of Revere. If the US had a 12% VAT, it would generate about $4 million to the US Treasury from my company. Revere's health care costs are about $2.5 million per year and FICA about $1.5. So at a 12% VAT, Revere's health care and FICA costs could be subsidized by VAT revenues. That would give Revere a 12% cost advantage against imports. This 12% advantage gained from the subsidies would be retained for exports since VAT is not charged for exports. What is good for Revere jobs is good for jobs in the USA.

Imagine how competitive that mining, making, growing or servicing anything in the United States would become under such a tax regime?

Companies outsource production to countries that have an attractive tax strategy. Even though many other countries have higher overall tax rates than the U.S., they are still better places to produce goods or services because they have a "smart" tax strategy. The national goal of many other nations is to achieve economic growth and attract jobs by facilitating outsourcing to them at our expense. The VAT is a major part of their National Trading Strategy**.**

The USA does not have a National Trading Strategy.

Other nations make strategic use of VAT to subsidize domestic production so the USA can import cheap goods and export jobs. VAT and numerous subsidies including currency manipulation are all part of having a National Trading Strategy to capture jobs from other countries like the USA and ensure the growth of their Gross Domestic Product or GDP.

GDP is equal to Consumption plus Investment plus Government purchases and Net Exports (the amount that exports exceed imports). Since US net exports are negative, we have a trade deficit which subtracts directly from our GDP. This explains the lack of U.S. economic growth. If net exports are positive, that drives GDP up and explains what is happening in China compared to the USA.

Wouldn't a VAT increase prices in the USA by the same amount?

No. In recent years, US producers have reduced prices in an attempt to offset foreign VAT and remain competitive. This pressure on prices has put pressure on costs and helps explain why real wages have not grown in the USA and investment has been so flat. Similarly, a US VAT would partly be eaten by foreign producers. US producers, now subsidized like foreign competitors for health care and retirement costs, would not raise prices fully if given such an opportunity to regain market share. A good estimate is that prices on a macro basis would go up by half of the VAT but vary by product.

So a VAT would cause real wages to go up and investment to increase.

Indeed, a US VAT would tend to strengthen the US dollar against other currencies. This would present a timely opportunity to take substantial action to offset currency manipulation by China and other Asian countries which would weaken the US dollar. Of course, that presumes we think strategically about international trade and have a National Trading Strategy.

As of March 2010, 19.7 million Americans are unemployed or underemployed in part time jobs because they can't find full time employment. That jobs gap for almost 20 million Americans is *above* the 4% level of unemployment considered to represent full employment.

The strategic use of a VAT is a good start to solve this problem.

The USA has a patchwork of inadequate trading tactics and no National Trading Strategy to compete for global trade and jobs. That's one good reason why the debate on VAT lacks focus. Virtually every regulation, statute or law impacts international trade competitiveness but none less than the absence of a strategic VAT in the United States.

It's all about trade. Trade is what determines the location of jobs.

M. Brian O'Shaughnessy is Chairman of Revere Copper Products and has testified before Congress four times on international trade as well as before the International Trade Commission. His company was founded by Paul Revere in 1801 and is the oldest basic manufacturing company in the USA.

Brian has appeared on BBC World News, CNN and been interviewed on Bloomberg on the Economy as well as PBS.

Brian@reverecopper.com (315) 338-2332

One Revere Park, Rome, NY 13440