Europe's Fatal Affair with VAT (Part II)
By Dr. Mason Gaffney

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EUROPE'S FATAL AFFAIR WITH VAT

by Dr. Mason Gaffney, Riverside, CA

(Part 1 of this paper was published in the January-February 2013 issue of GroundSwell. Part II continues here starting with the remainder of Section 3, From Common Market to European Union and VAT.)

With The Marshall Plan the U.S.A. undertook to help rebuild western Europe and Japan, with great success. "Social Democracy" was the slogan, to enlist proletarians in the common struggle against the Red Menace, which so quickly replaced the fascist menace of wartime. Former belligerents buried the dulled hatchets of nationalism. French leaders like Jean Monnet and Robert Schuman proposed a United States of Europe, to include the old Axis Powers, but not the USSR or its allies. France needed Germany to stop the USSR, and Germany was too big and robust for France to let go its own way again.

Initial steps like the European Coal and Steel Community and European Common Market grew to become the European Union. The 1957 Treaty of Rome created the European Community (EC), aka "The Common Market". In 1990 a commission led by former French Finance Minister Jacques Delors broached a single currency, a step short of political union. French President Francois Mitterand forced the Euro on a reluctant Germany as the price for France's support of German reunification after the Berlin Wall fell in 1989. The Maastricht Treaty of 1992 created the European Union (EU). The EU adopted the Euro. Soon the EU doubled in size, to 27 nations, including 8 former members of the Soviet bloc. France as the leader rode high. Germany's size and economic strength has now passed leadership partly to her.

Meantime, by 1954 the tide had turned back toward the attitudes of *l'ancien régime* with its taxes on merchants and their customers. Maurice Lauré, an engineer turned taxman, got France to adopt VAT "to meet a fiscal crisis" (although that kind of spin accompanies most political moves). VAT had political and administrative attractions, but economically speaking is only a variant form of sales tax. France introduced the first national VAT in 1954. It was not general, but destined to become so. President René Coty, not a name to remember, was the last President of the fractionated 4th Republic, but Laurés VAT was declared a success. Charismatic Charles de Gaulle succeeded Coty, founded the 5th Republic, and presided from 1959-69. A fabled war hero, he could get what he wanted, and was President in 1963 when a Common Market committee on tax "harmonization" issued the landmark (Fritz) Neumark Report that found the French VAT to be superior to Germany's cascading turnover tax. The Committee agreed to make VAT the basis of tax harmonization within the growing EU. In 1968 France changed its VAT from partial to general.

VAT spread quickly around Europe. The EC required member states to adopt VAT to enter the EU. Latin America also went along. In a second push around 1990, some industrial states like Canada, Australia, Switzerland and Japan came on board too, along with many "developing" economies in Africa and Asia, until today some 140 nations use VAT. They were pushed along The U.S.A. has played an anomalous role. The Shoup Mission to Japan in 1949 had tried to pioneer VAT there, although in vain. U.S.A.I.D. has spent huge sums promoting and subsidizing VAT in small nations. Only the U.S.A. itself has rejected VAT. Evidently there is a wide gap between our international representatives and the voters at home. By now, all "developed" nations except the U.S.A. have national VATs. Many leading U.S. economists are urging the same for the U.S.A., chiding us for backwardness. Many prominent economists are pushing parallel proposals as well, under forms like "the flat tax".

A united Europe with a harmonized tax system and common currency would seem to have realized the fondest dreams of founding fathers Schuman and Monnet. And yet, ...

Meantime mobile international capital is seeking security in U.S. Treasuries, in spite of our notorious flirtation with national bankruptcy. Here I advance a thesis that our LACK of a national VAT is a major source of U.S. fiscal strength vis-à-vis Europe; and that established standard-brand U.S. economists are seriously derelict in failing to point this out. Austrian-School economists are also derelict by failing to stress how VAT distorts the structure of capital, a topic in which they have special insight.

4. Europe after VAT: Troubles and Setbacks

Today in 2013 Europe is staggering. Many of its nations face bankruptcy. Its stronger members and institutions they dominate seek to impose "austerity" on the resentful weaker members. Its banks hold mostly its government's securities, crowding out small businesses that create most jobs. Its unemployment rates are breaking records. Its tax collections fall ever farther behind the needs, threatening both the governments and their bank-creditors with insolvency. Real estate manias in nations like Spain and Ireland, new to the perils of prosperity, have collapsed, bringing banks down with them.

Unemployment.

In September, 2012, the unemployment rate was 10.4% in the Euro area, and 23,3% for youths aged 15-25 Patterns diverge across nations, with the highest youth unemployment rates in Greece (55.6% in July), Spain (54.2%), Ireland (34.5%), Italy (35.1%) and Portugal (35.1%). Those are catastrophic numbers. Even in France, a pillar of European Union where VAT got started, the rate is 27.9%. Sturdy lowland and Baltic nations (continued on page 6)

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are not immune: rates in Belgium are 18.0%, Denmark 14.2%, Finland 18.9%, Luxembourg 18.6%, Sweden 23.4%. Central European Hungary, Poland, and the Czech Republic have high rates, too.

In Latvia wages are so low, and jobs so scarce, that she has that she has lost about 10% of her labor force to emigration, even as Christine LaGarde, Olivier Blanchard and other faces of the establishment proclaim it a success story. Mexico, guided by the IMF into NAFTA and neo-liberalism, stagnates while its oil riches keep its taxes low, it houses the world's richest person (Carlos Slim), criminal gangs take over whole provinces, and desperate poor pound on the doors to the U.S.A., and slip through cracks in the fences of our country, which finances the world's military without having any VAT at all.

Debts, Public and Private

The debts of Greece, Italy and Spain are in the headlines, but many "stronger" nations also owe more than their revenues can well handle. Greece owes $315 b, but here are the debts of some "strong" nations, in billions of $: Finland, 101; Austria 230; Belgium 374; Netherlands 427; and France 1,835. Even Germany, supposedly the EU's economic bulwark, began showing signs of stagnation in the 1990s, leading to the sarcastic epithet "The German Disease". Its debts are highest of all, at 2,086. Germany's "Miracle" seems slowly to be following an Olsonian pathway from unity and strength-through-defeat to disunity and weakness-through-success. Germany's claimed debt of about $2.1 trillions is rigged downwards by omitting huge pension obligations, estimated to add another $3 trillions to the total.

Some banks in greatest danger include Banco Santander (Spain), Credit Agricole (France), Commerzbank (Germany), Dexia S.A. (Belgium, and of course Bank Ireland. Germany's DeutscheBank, biggest in Europe, is not much stronger than Commerzbank.

Governments' creditors are mostly banks, but these in turn are bailed out by the same governments to whom they lend, a spiral winding only downwards until and unless European governments raise tax rates – and find a way to do so without stifling tax bases. The whole structure rests, finally, on tax revenues, lacking which it is just a house of cards. However, most tax bases fall when they are needed most, and the VAT base is falling fastest. In Greece, for example, public revenues have fallen 5% in the last year, while VAT revenues have fallen 15%. As credit ratings fall, required interest rates rise, so debt service rises, deficits rise, and debts keep growing, a disastrous vicious spiral. The resistless expansion of the EU stopped late in 2012 when Bulgaria refused to adopt the Euro for fear it would be called on to bail out even weaker nations.

Pop Keynesians may see this as a virtue: deficit finance is the way to spend our way out of recessions. That idea from 1936 would seem to have died with the Stagflation of the 1970-79, and again with the deficit-fueled crash of 2008, but it keeps returning. The unanswered question now is, who will lend when both borrowers and lenders lack the will and the ability?

How did Europe and its fellow VAT nations reach this sorry state?

5. Excess Burdens from VAT

The idea keeps resurfacing that a sales tax is made neutral by virtue of being "general". Many great economists have refuted it, only to be inundated by floods of lesser voices in mass textbooks.

Retail sales taxes, however "general" or universal in their apparent coverage, tax capital for turning over. Turnover is measured by the sales/capital ratio, which is highly variable among different firms, products, locations, stages of the cycle - and tax regimes, which economists influence. Sales taxes depress it heavily. This is not a mindless grouch at all taxes, for we need public revenues, and some taxes have positive effects. This is a rifle-shot at sales taxes, of which VAT is one.

To repeat for emphasis, retail sales taxes, however "general" or universal in their apparent coverage, tax capital for turning over. Turnover means replacement; and replacement sustains demand for labor. Replacement does not just depend on sales, it anticipates them, and thereby generates the consumer incomes that finance them: turnover is the autonomous variable that takes the lead in the otherwise circular and now vicious circle of macro-economics in which employers wait for consumers, while consumers wait for employers to hire them. Turnover is measured by the sales/capital ratio, which is highly variable among different firms, products, locations, stages of the cycle - and tax regimes, which economists influence.

Sales taxes depress turnover heavily, and thus shrink their own base. Arthur Laffer discredited this idea by letting his patrons apply it to ALL kinds of taxes; Murray Rothbard mistakenly applied it just to the property tax, the one major tax to which it does NOT apply because it taxes capital and land for standing still, not for turning over. These errors should not blind us to the truth in applying the idea to VAT and other sales taxes that "shoot anything that moves". In the lingo of public finance, they are contingent on "taxable events". Standard textbooks and learned papers tell us that a truly general retail sales tax, unlike an excise tax, is neutral as between one commodity and another. A national tax is also neutral between locations, since it is the same in one region as another. Those conditions are never approached in practice, but in the sales-tax canon that merely (continued on page 7)

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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)

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are taxed daily too, for they add to the gross value of sales. The value they add to the purchased stock of food is capital, too: "working capital". Or, if one prefers to ignore capital of life so brief and so small a claim on the final product, the sales tax is simply a tax on labor. The gross sales of parking lots, at the other extreme, include no turnover of capital at all, unless perhaps a minuscule Capital Consumption Allowance (CCA) on the paving and striping.

More generally, as Dan Sullivan points out, sales taxes penalize high-volume low-markup marketing strategies as against their opposite. Lest one turn up his nose at, say, Walmart, its low prices do not reflect low markup so much as low labor-service per dollar of inventory. It also provides acres of free parking, a service of land, like other big-box stores. Sullivan also notes that sellers in better locations, say Rodeo Drive, can have higher markups, so sales taxation favors better locations over marginal ones. New businesses with high startup costs can deduct them from taxable income, but not from gross sales. Clifford Cobb notes that ghettos have many barber shops and beauty parlors but few shops carrying commodities.

What Mill means by "capital" is clear from his memorable saying, "Capital is kept in existence from age to age not by preservation but by continual reproduction". Capital is not a specific concrete good, like a chair in the furniture shop. Rather, it is a quantum of value that we can, and normally do, keep existing by using the cash from sales to "meet the next payroll", as they say, to replace the chair. It needn't be an identical chair, or any chair at all, for capital in this transition is totally fungible in form and location.

Illustrations and Analogies

Within each business there are also differences among kinds of capital. In a retail bakery, for example, there are pies and pie-shelves. The pies come and go, perhaps several times a day; the shelves last for years; the ovens for decades; the buildings even longer; the sites forever. Many a needy widow with hardly any capital has earned her mite by baking, while renting the site, building and hardware. Her sales/capital ratio is high in contrast with that of the landlord, and orbital in contrast to, say, Georgia-Pacific or Weyerhaueser or Simpson or Ford's Roseburg timber corporations.

The case is even clearer when we compare two uses competing for the same land. The one with more turnover pays more sales tax per dollar of capital invested. The tax drives away capital that turns over fast, and reallocates the land to capital that turns slower, or to uses requiring less capital, or no capital at all, like the parking lot. As to the lot itself, it never turns over in the relevant sense of wearing out and being replaced.

Curiously, Harry G. Brown, a relentless critic of holding land idle, as well as of taxes with excess burdens, does not connect his two goals in one consistent system (1939, p. 254). He does not recognize that sales taxes inhibit using land intensively, if at all. His mentor Irving Fisher may have misled him. In Fisher's tax theory, all taxes should fall on consumption,

Chemists have a good vocabulary for it. Land in production is like a chemical "catalyst": it facilitates a process without disappearing into the product. Its "quantum of value" remains intact in the land. Working capital is, at the other extreme, like a "reactant": its corpus and its quantum of value go into the product. That means they get sales -taxed with each turnover – the basis of the Mill Effect.

Physiologists have a name for it, too: what is metabolism but the turnover of protoplasm in cells? One could elaborate, and find analogies from other sciences, but the point is made, and will be made once more below with Dorfman's essay on hydraulic engineering.

Difficulties, Solutions, and Measures

"Fixed" (durable) capital is a mixed, and therefore instructive story. The corpus of fixed capital as a catalyst does not get sales-taxed, only its income plus a little extra for depreciation get sales-taxed, as Mill wrote. Separating the catalyst from the reactant in fixed or durable capital is a trifle less simple than with working capital, but only marginally so. The basic mathematics of finance tells us exactly how to divide the product between interest, the net income of capital, and depreciation, which corresponds to the recovery or turnover of capital (and is labeled a "Capital Consumption Allowance" (CCA) in NIPA). We do not repeat the mathematics here, but lenders, mortgagors, bankers, and I.R.S. agents use it every day. So do millions of innumerate consumers who buy on the installment plan, taking the mathematics on faith. The writer has often spelled it out for students in class notes.

A unit or "quantum" of fixed capital embodied and frozen into, say, the Oroville Dam, or the long Honshu Tunnel, or grading building sites, or land-fill in shallow water, or The Pyramids, or The Brooklyn Bridge, or the marble cladding of Nelson Rockefeller's Parthenon in Albany, turns over so slowly that its net product or service after O&M is mostly pure income. That product or service as a tax base, however we measure it, includes little recovery of capital. Too often, indeed, there is none at all, thanks to engineering megalomania coupled with the "irrational exuberance" of land speculators and "earmarking" politicians who trade subsidies for campaign contributions.

As to land, this never turns over. Its ownership may turn over many times, but that is an entirely different meaning of "turnover": it entails no depreciation and ultimate replacement of the lot, and no routine recovery of the original purchase price through a CCA (Capital Consumption Allowance). In a rational market, land is priced so high that its cash flow is just enough to cover interest on its price, with nothing left over for a CCA. In a rising but still rational market, indeed, interest on the price is greater than cash flow by an amount equal to annual appreciation. In a market with "irrational exuberance", which comes along in a regular cycle of 18 years or so, interest often exceeds the sum of cash flow and appreciation, as we learned so well in 1990, promptly forgot, and went through again in 2008, and are beginning a (continued on page 9)

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new cycle of forgetting in 2013 as I write.

Many economists disregard The Mill Effect by assuming, too blithely, that sales taxes are all shifted forward to "consumers". Even if that were 100% true it would certainly depress demand for the overtaxed items. Most economists today share some, at least, of the paradigm of Buchanan and Flowers wherein sales taxes are shifted backwards to factors of production. There is a hint of this in Mill (Bk V, Chap 5, p.517), but the stronger recent statement is in Harry G. Brown (1939). Earl Rolph, crediting Brown, agrees (1952). Richard Musgrave, crediting both Brown and Rolph, endorses this approach in the main, too (1953, p. 318; 1959, p.379). Many of us now hew to the Physiocratic doctrine that All Taxes Come Out of Rents (ATCOR). Either way, sales taxes create "A disturbance in The Force" – a massive and basic disturbance. To fuss over trivia, while missing the Mill Effect, would be to strain at gnats while swallowing a camel. For examples of such straining see Shoup and Haimoff, Somers, Rolph/Break, and almost any popular text on public finance.

Many texts on public finance compare a retail sales tax favorably with a "turnover tax", since the latter taxes every transaction up to and including the retail stage. Thus they dispose of "turnover" by giving it an entirely different meaning than that used by Mill, and used here. They criticize a "turnover tax" (as sometimes used in Germany, and in the former Soviet Union, and now in Ohio) for taxing the same capital several times, "in cascade", as it moves from owner to owner in successive transactions through the "stages" of production. They then criticize how firms may avoid it by integrating vertically. Fair enough, but then they dust off their hands as though done, leaving us the retail sales tax, imposed at only one "stage" of production, as though it were free of taxing turnover. Thus they purge The Mill Effect, the "Disturbance in The Force", from modern fiscal economics.

Mark Skousen, presents a long valuable list of previous texts and learned writings supporting Austrian capital theory (Chap. 4, pp. 84-130 et passim). He argues against policies that drive capital away from "lower order" capital goods that turn over quickly because they are near to the final consumer. You would therefore expect him to take the lead against retail sales taxes, with their bias against these lower order goods. Instead, Skousen switches to another paradigm and favors sales taxes on the grounds that final consumers bear them, and this exempts saving and capital formation. The writer has refuted this belief elsewhere (2009), and will not repeat the reasoning here.

As to the structure of production, Skousen writes that "... a consumption tax ... would be highly favorable toward the earlier stages of production," (p.345). But "earlier stages of production" means UNripe capital, at farthest remove from final consumers, capital that ripens and turns over slowly, the kind that Austrian theory tells us to treat LESS favorably, or at least NOT favorably. I will not labor the obvious contradiction, but simply express dismay that no Austrian economist, to my knowledge, has ever used Austrian-derived paradigms to criticize sales taxes.

Skousen also gives priority to repealing the "capital gains tax", evidently believing that it is a tax on capital, as its name misleadingly suggests. Actually, most unearned increments of value come from land. Taxing or untaxing them has no direct effect on the structure of capital proper. Most real capital depreciates with time. There are some exceptions, like commercial timber and other biological capital that does add value with time. Here, a pure gains tax would indeed contain a small bias in favor of slow turnover, since the tax is deferred until sale (Gaffney, 1957, 1970-71, 2006; Vickrey, 1971). The capital gains tax as we know it in practice, however, is structured to impose higher rates on faster turnovers.

Richard Musgrave does cite the "Swedish Austrian", Wicksell, who published in German on tax policy, and with great insight. In arduous and obscure prose (pp. 392-99), Musgrave finally, grudgingly, finds a tax on "gross receipts "leads to a lengthening of the average period of investment" (pp. 396-97).

As to definitions and measurement, some economists see nothing but insoluble problems in measuring or even conceiving of the lifetime of a simple capital item, and even worse problems with the average lifetime of a collection of heterogeneous items. The matter may be made to seem hopelessly complex, and a battery of economists, following J.B. Clark and Frank Knight, ever stand too ready to oblige.

Fred Foldvary, an "Austrian" thinker, neatly solves the problem by distinguishing concrete items of capital as "capital goods", while "capital" standing alone means the quantum of value. This quantum of value is relayed from one concrete capital good to another with each turnover (cycle of liquidation and replacement). In this relaying the capital becomes completely fungible in form and composition and location. Fungibility is a concept that most economists grasp and teach, although some resist the idea of capital as a quantum of value – something more obvious to accountants, however, and, as Dorfman showed, to hydraulic engineers.

Hydraulic physics and engineering provide a simple solution, ably expounded by Robert Dorfman in an article I cannot praise too highly (1959). Dorfman whimsically calls it "The Bathtub Theorem", and properly acknowledges Knut Wicksell's priority with his "grape-juice model", although Dorfman's model is more general. The average transit time of a molecule of liquid through a reservoir is basically the flow/fund ratio: in economic terms, the sales/capital ratio (p.353 et passim). For the lady baking pies and selling out daily the annual ratio is 365. For the boreal forester the annual ratio is 1/70. Both figures may be modified slightly for elegant variations on the main point, but the difference of 26,000 times illustrates the Mill Effect so starkly, why bother with more? For doubters and masochists Dorfman provides many equations, but ends them delightfully saying "It is nice that this elaborate calculation is really unnecessary" (p.372).

Dorfman does not treat land separately, which is a fault. Neither does he analyze sales taxes and their effects. This writer has tried to supply the lack (1976, mathematical appendix). For now it is enough that we can measure turnover simply, and it varies hugely among sales-taxable items and firms.

Professor William Vickrey (1971) contributed a general mathematical model published as an Appendix to my "Tax-induced Slow Turnover of (continued on page 10)

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Capital", showing how "Yield Taxes" (sales taxes on timber harvests) slow down average rotation periods. He equates average tree life with the sales/capital ratio simply by inverting the order of integration – a simple trick for him, a math major (1971). It was consistent with his lifelong efforts to tax capital gains as they accrue, following the Haig-Simons definition of income.

Summary

We are left with this. Jobs depend on turnover. Turnover is measured by the sales/capital ratio, which is varies hugely among different firms, products, locations, stages of the cycle - and tax regimes. Elected officials control the last, and we as economists try, at least, to influence elected officials. Sales taxes, rampant and rising in our times, depress turnover heavily, and so depress demand for labor – both the number of jobs and their pay rates. Property taxes have the opposite effect, and so may some aspects of income taxation. We do not here address how both property and income taxes may be modified for the better, although they may and should be. Our main point here is that sales taxes (and their twin, VAT) are among the worst possible choices when the objective is to make jobs and raise pay rates.

The U.S.A., with all its faults, has no national VAT. We do not lack for crusading VATsters. They chide us for being behind Europe, where all nations in the EU depend heavily on VATs, the dependence rising fast ever since France introduced it in 1954. As the EU careens to financial crisis, and derivative political crises, while world capital flees for refuge in the U.S.A., the evidence of history is not speaking well for VAT. Forecasting is perilous, and some see doom ahead for the U.S. dollar, but as of this writing the evidence is against VAT.

6. Scholarly origins of and support for VAT

We have seen how Maurice Lauré pioneered VAT in France in 1954, whence it grew with the idea of European Union, before going viral around the world. Lauré was not the first to broach the idea, however. Others had been tilling the seedbed before. Of course, everyone touting a retail sales tax had been conditioning minds for years before, but there were only few who limned out the specific form of VAT.

One was the American economist Thomas S. Adams (*QJE* , August *1921*). Adams was disturbed by the growth of income taxes, especially on "business" (property) incomes, and proposed substituting a national tax on gross sales. His prose was muddy and equivocal, and anyway, Andrew Mellon soon led Congress to lower surtax rates on high incomes, relieving much of rich families' grievances and Adams' case against income taxes.

Another was Wilhelm von Siemens (1918), who saw VAT as a technical improvement to avoid cascading in the German sales tax. Siemens could cite some earlier pamphlets as supports, but they and he were only on the margins of power and there was no followup. Soon German governments, saddled with debts and reparations, turned from collecting taxes to printing money, causing one of history's worst hyperinflations.

The high income-tax rates of W.W. I in the U.S.A. led to a spate of proposals for a national sales tax in the U.S.A. including some from Andrew Mellon, W.R. Hearst, Ogden Mills, and his friend R.T. Ely. While they never prevailed nationally, their views reinforced a climate of opinion that influenced the many states that rushed in a horde to substitute retail sales taxes for property taxes in the 1930s. Another less obvious factor was the 18th Amendment (Prohibition) which cut deeply into Federal revenues from sumptuary excise taxes on alcohol, forcing more reliance on income taxes, both corporate and personal. The du Pont family subsidized the campaign to repeal the 18th Amendment, a less extreme but more successful move to relieve themselves and their class from income taxes. The du Ponts, as major owners of GM, also had an interest in holding down gasoline taxes.

The next tranche of advocates included scholars Irving Fisher, Kaldor, Meade, and Prest. Following W.W. II Professor Carl Shoup of Columbia joined the tranche. General Douglas MacArthur as head of SCAP was in a position to dictate many policies to occupied Japan, and he picked Shoup to head an advisory group on tax policy. Shoup, of professorial and objective mien, was the scion of Paul Shoup, President of the S.P. R.R. and developer of upper class Los Altos in San Mateo County. Shoup came out strongly for a VAT. Shoup was one of the first American economists to push VAT abroad. Like MacArthur, he hoped that his policies applied first in a foreign nation would set an example to be followed in the U.S.A. itself, but it did not work out that way, either for him or later Americans working for the IMF, World Bank, OECD, and other international bureaucracies.

More recent champions are Pete Peterson, Harold Somers, Michael Dukakis and his advisor Larry Summers, Cary Brown, James Buchanan, Paul Krugman. G.N. Hatsopolous, James Poterba, Steve Forbes, Rick Perry, Robert Hall and Alvin Rabushka backed by The Hoover Institution, Newt Gingrich, Milton Friedman, Richard Armey, Henry Aaron, Charles McLure, Richard Lindholm, John Due, Raymond Mikesell, Arnold Harberger, and many others. The Republican platform of 2012 even included a plank to repeal the 16th Amendment and adopt a national VAT. Centrists scoffed at the extremism, but in our times we have seen how fast, sometimes, extreme becomes mainstream.

7. International Enforcement Agencies for "Harmony", Lending, and Collections

European Union has required and spawned its own governing legislatures and bureaucracies in bewildering array, layered on top of existing national bureaucracies. These new agencies take on powers and lives and (continued on pg. 11)

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(from page 10)

agenda and academic satrapies of their own, like our own Federal Reserve System. The details are complex and interwoven, constantly discussed in media reportage and new books beyond our need to rake over here. Like most bureaucracies they tend to aggrandize and perpetuate themselves and freeze in place, as generations of libertarians preach. Perhaps the preachers and their exegetes overstate it. A major recent shift is evident. Control has shifted from Social Democrats to Conservatives representing bankers and other lenders. A critic describes them as the "giant Goldman-Sachs squid". The metaphor is exaggerated, but a useful mnemonic of where power now lies.

In 1998 the OECD was pressuring errant nations to raise tax rates. It campaigned against tax regimes it stigmatized as "harmful" because they might attract mobile capital. Today in 2013 raising income taxes is off the table, unthinkable, unmentionable, a solecism. The prevailing dogma is that raising tax rates would only choke recovery and lower the tax base, as Laffer once warned. The focus is on "austerity", meaning to lower spending on social programs, and force down wage rates. Protesters in debtor nations see The Troika and its appanages as a hydra-headed cartel of bankers and Germans to reduce them to debt slavery. Conspiracy theory and paranoia? More likely what we see is just the unconscious or semi-conscious comity of people with common interests working in harmony. Either way the results are much the same.

One thing the old and the new EU agencies share in common is making an ideal of tax "uniformity" among nations. Sales-taxers have long seen their need for the same ideal within nations or even big states. For example in 1955, California sales-taxers invoked the doctrine of "uniformity": if only every city raised the sales tax, no retailer or buyer could escape it by fleeing to a city without one. Accordingly, our Legislature encouraged local sales taxes statewide. The State collects it, and returns it to each municipality of origin. A central power can overcome interjurisdictional tax competition, as Europe's Troika agencies are attempting now. Thus, EU was the necessary pre-condition for VAT. The two have grown together, as shown earlier herein.

Why do lender groups come to the aid of debtors approaching peonage? It is a survival mechanism found in nature. Most parasites stop short of destroying their hosts because each needs the other. Most predator populations leave behind a saving remnant of their prey to supply the next generation of their food supply. Mankind most consciously saves both the seed corn and the breeding stock for future generations. Thus lender groups have an interest in keeping borrowers solvent enough to repay the principal of debts, while also risky enough to have low credit ratings calling for high interest rates. Lenders also want to discourage debtors from seeking other lenders, and maintain a united front to discipline debtors who default.

The idea that Europe has reached the limit of its taxable capacity is nonsense in the light of history. The Cold War wound down from 1989. Today the U.S.A., the only nation with no VAT, bears the cost of policing and defending Europe, and most of the world too. Europe for centuries before now poured its treasures into a series of internecine wars from which the EU has rescued it. Europe now enjoys a colossal Peace Dividend, one of the biggest and longest in history. The idea that this should lead to national bankruptcies is absurd and ridiculous on its face. The alternative hypothesis is that Europe's woes are endogenous. A major cause, as shown earlier, is heavy reliance on VAT – the main tax to which Laffer's warnings might apply – and the lack of substantial taxes on property or its income. The evidence of Europe's solvency and untapped taxable capacity is the high level of its land prices compared with ours. International buyers are paying record-smashing figures for homes in world-class neighborhoods like Woodside and Los Alto Hills, San Mateo County, for example, because our prices, steep as they look to us, are still cheaper and the quality of life may be better than in counterpart regions of Europe (LAT 1-29-13, p.B5).

The bottom line is that Europe is strangling itself with VAT, while the U.S.A., for all its many serious faults, is surviving better without one. We still cling to the remnants of a property tax system inherited from earlier times when we led the world in real production and real per capita income, making us a magnet for immigrants from the world – from the "wretched refuse" kind to the most talented, both of whom strengthen us when we offer them chances to work and invest productively. We have an income tax system that, while riddled now with counterproductive loopholes, still prohibits the tax-depreciation of land and occasionally succeeds in taxing the unearned increment of land values. We still find some investment "loopholes" that were designed constructively to reward real income-creating investing
in new capital. Let us pray that the python of VAT never wraps us in its coils; let us work to make that prayer come true.

Appendix I: How Gigantism in Banking Reinforces the Bias Against Turnover

The following is an excerpt from Stacy Mitchell, "How State Banks Bring the Money Home", *Nation of Change.org*, Sept 15 2011.

One of the most significant, but least noticed, consequences of the rapid and dramatic consolidation of the banking industry over the last decade is how much it has hindered the U.S. economy's ability to create jobs. To begin to understand this, take a look at each end of the banking spectrum. On one end are the nation's 6,900 small, locally (continued on page 12)

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(from page 11)

owned, community banks. These institutions control $1.4 trillion in assets. That's 11 percent of all bank assets. They currently have $257 billion in loans to small businesses and farms on their books.

On the other end, four giant banks—JP Morgan Chase, Bank of America, Citibank, and Wells Fargo—now command $5.4 trillion in assets, or 40 percent of the total. Given that they are nearly four times as large as all local banks combined, one might expect that they would have made four times the small-business loans, or about $1 trillion. In fact, these banks have a mere $85 billion in small-business and farm loans on their balance sheets.

Why do giant banks make so few small-business loans? Automation is the short answer. The only way these sprawling institutions can function efficiently is by taking a mass production approach to lending: Plug credit score, income, and appraisal into the computer—out comes the loan. That's why the mortgage-business was supposed to be so safe. The economic meltdown of 2007 shows that it's actually very risky.

Small-business loans are not so easily mechanized. Each is a custom job, requiring human judgment to evaluate the risk associated with a particular entrepreneur, a particular business plan, and a particular market. Community banks excel at this. Their lending decisions are made locally, informed by face-to-face relationships with borrowers and an intimate understanding of their hometown economies. Big banks, whose decision-making is long-distance and dictated more by computer models than judgment, are pretty bad at it. So they don't make many small-business loans.

It's no wonder, then, that unemployment has been so persistent. Our financial system is top-heavy with big banks that are scaled to meet the needs of large multinational corporations. The Commerce Department estimates that U.S.-based multinationals have eliminated 3 million American jobs over the last decade. Meanwhile, small businesses, historically responsible for about two-thirds of new jobs, have found it harder and harder to obtain credit.

In short, we have a financial system that is mismatched to the economic needs of American communities. This mismatch will become more acute as we attempt to transition to a carbon-efficient economy, which, by its very nature, will be the domain of small-scale enterprises: local food producers, community-owned wind and solar electricity, neighborhood stores that provide goods within walking distance of homes, and so on. To take root, these businesses will need a robust array of community-based financial institutions capable of meeting their capital and credit needs.

(GroundSwell does not have room for footnotes, but they are available from Economics Professor Dr. Mason Gaffney, email m.gaffney@dslextreme.com) <<

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URBAN LAND IS COMMON WEALTH (from pg. 4)

(Editor's note: On the Commons is a network of citizens and organizations working toward a commons-based society. The commons refers to the natural and socially-created commons belonging to all of us that - when used wisely and fairly - will benefit everyone, including future generations.

(Rich Nymoen, Maplewood, MN, can be emailed at rnymoen@aol.com. Jeffery Smith, Portland, Or, can be emailed at jjs@geonomics.org) <<

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COMMON GROUND MEMBERS TO SPEAK AT 2013 CGO CONFERENCE IN PITTSBURGH

by Sue Walton, Evanston, IL

The following sessions are just a sampling of the many and varied workshops that compose the program of the 33rd Council of Georgist Organizations' Conference Centennial Celebration to be held August 6-10, 2013 in Pittsburgh, PA.

Common Ground members Ted Gwartney, Bill Batt and Mike Curtis will be speaking on "The Politics of Assessing on Wednesday, August 7th. Later that day CGUSA members Paul Justus, who will host the session "100 years of Georgist Music", and Alanna Hartzok, Cathy Orloff and Toby Lenihan will perform. Paul and some of his friends recently entered a contest on PBS regarding the anniversary of Woody Gutherie's "This Land is Your Land". More about the group in Eureka Springs can be accessed at http://www.pbs.org/wnet/americanmasters/this-land/videos/this-land-is-your-land-project-share-the-earth-singers/.

On Friday, August 9th, Canadian CGUSA member, Frank de Jong will speak on "Introducing our Vision to Average Communities".

For more information or to receive a conference brochure, if you have not already, please contact Sue & Scott Walton at: 847/475-0391 or at sns@swwalton.com. <<

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INTERNATIONAL CONFERENCE TO BE HELD IN LONDON.

The International Union for Land Value Taxation, of which Common Ground-USA is a member, has announced that its 28th conference will be held July 24-28, 2013 at The School of Economic Science in London, England. The theme is Economics for Conscious Evolution. For more information, please see their web page, http://www.theiu.org/.
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