Comments to the National Commission on Fiscal Responsibility and Reform

The Commission seems likely to list a value-added tax (VAT) among the options for reducing fiscal deficits. It may be helpful to consider how a VAT affects the consumer price index (CPI) and any payments based on the CPI.

Let's assume the U.S. enacts a VAT at a 10% rate, either all at once or phased-in. Then the CPI will go up by 10% to the extent the VAT applies to goods & services being measured in the CPI. It's likely that food and a few other essentials would not be VATable or would take a lower rate, so the CPI would increase by a rate between zero and 10%.

How do we know this CPI treatment is likely? That's how it works in Canada, the UK, etc. Our current CPI includes state sales taxes in consumer prices, a strong precedent. And politicians probably wouldn't want to dilute the CPI, such as by applying a complex adjustment to back out the VAT from prices, on top of imposing a new tax.

If the CPI does go up to reflect a higher VAT rate, under current law this increases various government payouts, including Social Security benefits, federal employees' and military pensions, and TIPS principal & interest. The opposite occurs when VAT rates go down, as has happened in other nations. In a year when VAT rates aren't changing, the VAT doesn't affect the rate of CPI increase one way or the other. Social Security projections would show the OASDI trust funds running out of money sooner than they would without a VAT.

CPI increases may also affect payments by state & local government, and wages & prices throughout the economy.

The Commission may want to discuss such secondary effects of a VAT in its forthcoming report.

Respectfully submitted,

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