

## THE SOLUTION

*Former U.S. Sen. Ernest F. "Fritz" Hollings (D-S.C.)*

JULY 21, 2009 -- The administration now says it underestimated the severity of the economic downturn. But the truth is it overestimated the effect of stimulation. In the Bush eight-year term, we increased the debt or stimulated the economy \$5 trillion. In the same period, household debt increased or stimulated the economy an additional \$7 trillion, for a total of \$12 trillion stimulation in eight years. This year's deficit has already added another \$1.5 trillion additional stimulus and we are still losing jobs like gangbusters. Stimulation has spent its effect.

Now we must turn to globalization and the loss of jobs from offshoring. Globalization is nothing more than a trade war for market share with production looking for a country cheaper to produce. Japan started this trade war for market share after World War II by closing its market, subsidizing its production, and selling its export near cost, making up the profit in the closed market. It worked. Toyota is No. 1 while GM declares bankruptcy. Now China has the supermodel of a closed market, controlled labor, and protectionism for its production and trade as the United States blindly cries "protectionism" and remains AWOL in this trade war. Two years ago, the Princeton economist, Alan Blinder, estimated that the country is losing three to four million jobs a year to offshoring. The principal problem with the economy is that it is being offshored. The United States must come in from the cold and engage in the trade war. Fortunately, we can do this by solving the problems now facing Washington.

The Democrats' problem is to pay for health care. The Republicans' problem is to cut taxes and stop deficit spending.

Replacing the corporate tax with a 5% VAT will cut taxes, pay for health care, and stop deficit spending.

Replacing the nation's corporate tax with just a 3% VAT is tax-neutral. In 2008, the corporate income tax was \$304 billion. In 2008, U. S. GDP equaled \$14.3 trillion. But a VAT is not applicable to the public sector GDP. State, local and federal governments accounted for \$1.8 trillion of GDP, leaving a private sector GDP of \$12.4 trillion. Three percent of \$12.4 trillion is \$372 billion. We had goods and services exports of \$1.8 trillion in 2008, with a 3% rebate of \$54 billion. In 2008, we had \$2.5 trillion of imports, with a 3% VAT equaling \$75 billion, for an actual net of \$21 billion. The \$21 billion added to the \$372 billion approximates the \$393 billion in corporate income tax revenues for last year for a better than revenue-neutral replacement.

At the current level of a private sector output, each 1% of that would raise approximately \$131 billion. One percent more over ten years would raise the \$1 trillion, 310 billion, needed for health care and, for good measure, another 1% would pay for the final cost of health care and stop deficit spending.

The average VAT of industrialized nations in globalization is 17%. Replacing the corporate tax in the U. S. with a 5% VAT will:

- (1) cut taxes;
- (2) pay for health care;
- (3) remove Corporate America's incentive to offshore production, jobs, and the

- nation's economy;
- (4) give every reason for the U. S. multi-nationals to bring home their foreign parked capital, investing in the United States and producing jobs;
  - (5) make the U. S. a magnet for foreign investment;
  - (6) promote exports and make U. S. production cheaper abroad, narrowing the deficit in the balance of trade;
  - (7) make imports more expensive -- with imports carrying their share of health costs and the replaced corporate income tax;
  - (8) the VAT would collect something from the 20 million underground illegals who now receive health care free in our emergency rooms;
  - (9) the VAT would collect from the underground economy (drug traffickers when they spend their illegal profits);
  - (10) With the highest corporate tax rate of 39% and an average

of 27%, a 5% VAT would reduce the cost of domestic production 22% and reduce the cost of American made products to consumers.

It will take some time for business and the IRS to gear up for a VAT. That time is best used now by canceling the corporate tax and making the 5% VAT effective in 2011 – after the election in 2010. At present, trying to pay for health costs, we are turning off different groups with payroll taxes, health benefit taxes, soft drink taxes, Medicaid costs, small business taxes, sur-taxes, deficit spending, unfunded mandates, etc., organizing the defeat of health care. Instead, we should turn on these groups to support health care by replacing the corporate tax with a 5% VAT. I understand that Larry Summers wants to withhold a VAT for tax reform. But the most difficult part of tax reform is instituting the VAT for mere reform. With a VAT in place, Summers will have solved half of his headache of reform. A 5% VAT now will solve the problems of tax cuts, deficit spending, the cost of health care and make Corporate America more competitive in international trade. Instead of offshoring the economy, we can repower our economy.

*Senator Hollings of South Carolina served 38 years in the United States Senate, and for many years was Chairman of the Commerce, Space, Science & Transportation Committee. He is the author of the recently published book, [Making Government Work](#) (University of South Carolina Press, 2008).*