

TIME TO REPEAL THE COLD WAR TAX

The collapse of the Soviet empire and the end of the Cold War have made the world a safer place. They also have created a long overdue opportunity to reduce the tax burden on Americans. With significant reductions in previously-projected defense spending likely to occur in future years, Congress quickly should enact tax reduction legislation. Lowering taxes will stimulate an economy burdened by excessive government and hampered by last year's decision to enact the largest one-year tax increase in American history. Moreover, a commitment to reduce taxes will preclude special interest schemes to use savings in the defense budget to fuel yet another domestic spending binge.

Several lawmakers seem to understand the importance of trimming spending—domestic as well as defense—to help finance a reduction in taxes. Senator Bill Bradley, the New Jersey Democrat, this week proposed legislation giving families a \$350 tax credit for each dependent child. This \$116 billion, five-year tax cut would be offset by a \$118 billion reduction in currently projected spending totals over the five-year period. Even House Majority Leader Richard Gephardt, the Missouri Democrat, declared in uncharacteristic fashion that “We would like to see if we can return some of the money to the American people.” On the Republican side of the aisle, tax cut proposals range from economic growth legislation proposed by Senator Malcolm Wallop of Wyoming and Representative Tom DeLay of Texas (S. 381, H.R. 960) and California Representative David Dreier (H.R.3290) to family tax relief bills introduced by Senator Dan Coats of Indiana and Representative Frank Wolf of Virginia (S.710, H.R.1277).

To the extent there is the peace dividend, other than peace itself, the money should go back to the American people. Since the end of World War II, the American taxpayer has paid a heavy price defending the world from Soviet aggression. The defense budget, just like any other form of government spending, diverted resources out of the productive sector of the economy. Money spent on battleships, jets, missiles, and tanks was money that families and businesses could have spent on education, factories, homes, and jobs. The price of freedom was heavy.

Remaining Prepared. Unlike many other government programs, however, the money spent on defense actually produced results. Ronald Reagan's restoration of America's defenses in the early 1980s, combined with the Soviet economy staggering to a halt thanks to seventy years of socialist central planning, finally brought about the Soviet Union's political collapse. The apparent end of a major military threat from what remains of the Soviet Union does not mean, of course, that the United States can dismantle its defenses. The recent conflict in the Middle East and the continued potential for dangerous turmoil in the former Soviet Union are strong arguments for caution and military preparedness. In particular, the U.S. must be ready to defend itself from sudden attack by smaller countries with high technology weapons, rather than guarding itself primarily from large-scale assaults. This danger underscores the case for a shift in military resources to such programs as the Strategic Defense Initiative. But this prudent restructuring of the U.S. arsenal still could free up tens of billions of dollars.

The growing bipartisan consensus for tax relief, however, does not guarantee taxpayers will reap the benefits of a lower defense budget. Powerful lawmakers on Capitol Hill are eager to use defense budget savings to create new domestic spending programs or expand existing ones. As a result, even though last

year's budget deal already means record increases in domestic spending, many lawmakers envision a surge of new domestic spending. This will mean tax relief is sacrificed at the altar of special interest politics.

Arguments for more domestic spending have little merit. Whether measured in nominal or inflation-adjusted dollars, domestic spending is at record levels and increasing rapidly. Because of last year's budget deal, domestic discretionary spending will grow 91 percent faster than needed to keep pace with inflation between 1990 and 1993, while domestic entitlement spending will climb 131 percent faster than inflation from 1990 to 1996. And unlike the money spent for defense, it is not easy for advocates of increased domestic spending to identify programs that already have solved the problems for which they were created. Poverty rates have become more intractable and families less stable since the War on Poverty began. Student test scores have fallen as federal aid to education has mounted. Indeed, in general, the federal government seems ill equipped to solve many of the problems that exist in America, and in several instances its programs may make the problems worse.

The dismal record of federal attempts to combat domestic problems suggests what is needed is not more money but a change in strategy. If lawmakers truly are concerned about poverty and falling living standards in America, for instance, they should cut taxes. After Reagan's tax cuts were fully in place, the economy began its longest-ever period of peacetime growth. During that economic boom, the official poverty rate fell from 15.2 percent to 12.8 percent, inflation-adjusted gross national product climbed 32 percent, over twenty million new jobs were created, and inflation-adjusted average income for even the poorest 20 percent of households jumped by 12.6 percent.

Undoing Damage. Using the peace dividend to cut taxes would do far more to deal with the domestic problems faced by Americans than a raft of new programs. More immediately, a tax cut would help undo some of the damage caused by last year's ill-conceived budget deal. The current economic stagnation is in no small part a result of the record tax increase imposed on America's workers, consumers, and businesses last year. Before the tax increase, politicians promised that the money would be used to reduce the deficit. But as usual, the new tax revenue was exaggerated because policy makers ignored the fact that higher taxes slow the economy. The shortfall in tax collections caused by the recession, combined with unwarranted increases in domestic spending, has pushed the projected deficit in fiscal year 1992 to \$350 billion, an all-time record.

Policy makers have what should be an easy choice. Do they transfer defense savings to domestic spending programs, leaving the tax burden on the productive sector of the economy unchanged? Or, do they use this historic opportunity to grant sweeping tax relief to American families and businesses? The answer should be clear.

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For Further Information:

Daniel J. Mitchell, "Tax Rates, Fairness, and Economic Growth: Lessons From the 1980s," *Heritage Foundation Backgrounder* No. 860, October 15, 1991.

Stuart M. Butler, "The Peace Divided: It Belongs to the People, Not Congress," *Heritage Foundation Backgrounder* No. 752, February 9, 1990.