The Heritage Foundation Backgrounder UPDATE

214 Massachusetts Avenue N.E. Washington, D.C. 20002-4999 (202)546-4400

11/8/91 Number 170

WASHINGTON'S TAX CUT CONVERTS: RECOGNIZING THE SINS OF LAST YEAR

(Updating *Backgrounder* No. 865, "The Tax Cut Budget Package That America Needs," November 8, 1991.)

The recent flurry of tax cut proposals on Capitol Hill certainly is a welcome change of pace for Americans who last year saw their taxes increased by a record amount. It probably came as no surprise to Americans that these tax hikes helped throw the economy into a deep recession and are smothering prospects for recovery. Taxpayers thus should not forget those Washington politicians who voted for the higher taxes and who therefore are guilty of much of the recession suffering. After all, those politicians should have known that a record tax increase would destroy jobs and harm the economy.

Voters certainly seem to understand the relationship between taxes and economic growth. As this week's elections have confirmed, Americans have had enough of high taxes and they reject government officials associated with those policies. In Pennsylvania, former Governor and U.S. Attorney General Dick Thornburgh, closely identified with Bush Administration policies as former chair of the White House's Domestic Policy Council, lost a 44 point lead and suffered a near landslide defeat in his race for the Senate. In New Jersey, Republicans found themselves on the right side of the tax issue. Voter anger over Democratic Governor James Florio's record tax increase paved the way for Republicans not only winning control of both chambers of the state legislature, but doing so by stunning, veto-override margins. Voters in Missouri also expressed their opposition to higher taxes, trouncing an initiative that would have raised taxes to finance more education spending by a 2 to 1 margin.

Heavy Cost. Despite the human misery caused by the current recession and strong public support for economic growth policies, many members of Congress and the Bush Administration still oppose measures that would cut taxes and reverse the damage done by last year's budget deal. George Bush's betrayal of his 1988 "no-new-taxes" pledge and his ill-fated return to the tax-and-spend policies of the 1970s already have imposed a heavy cost on American workers and families. As Ronald Reagan accurately noted this August, "...the tax hikes of last fall are already proven failures, which cost Americans millions of jobs and actually lost revenue for the Government....When will Washington learn? When you tax production and growth, you get less of both."[1]

Recent talk of enacting 1980s-style tax cuts is a long overdue sign that Washington may be acknowledging, finally, that Reagan's policies worked. But for the millions of workers waiting in unemployment lines, the countless families whose living standards have dropped, and the record number of individuals and businesses forced into bankruptcy, no future tax cut can erase their suffering. Even if the growing recognition that last year's disastrous budget deal harmed the economy eventually leads to enactment of a pro-growth tax cut this year or next, for many families and workers it will be too little and too late.

---

1 Videotaped address to The Heritage Foundation, August 13, 1991.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Ironically, many of the politicians now proposing tax cuts are the very same ones who caused the current economic crisis by supporting the 1990 budget agreement. They surely deserve praise for their tax cut proposals. But American workers and families certainly would be in a stronger position if they had voted against last year's budget deal instead of supporting it.

Stubborn Opposition. Even the White House, which last year cavalierly imposed the largest ever tax increase on the American economy, now is rumored to be contemplating support for a mild growth package sometime next year. Of course, the economy would be in much stronger shape today if the President simply had kept his no-tax-increase promise in the first place. Some members of the President's Administration, however, most notably Budget Director Richard Darman and Treasury Secretary Nicholas Brady, stubbornly continue to oppose economic growth policies and appear to have convinced the President that nothing need be done. Voters justifiably may wonder how many more jobless workers, failed businesses, and suffering families it will take before the White House finally jettisons the deeply flawed 1990 budget agreement.

Some politicians who supported last year's record tax increase are attempting to duck responsibility for the subsequent economic crisis by denying that there was any indication that raising taxes last year would cause the economy to decline. Almost from the moment that the budget summit began in May 1990, however, economists warned lawmakers that a tax increase would backfire. A Heritage Foundation study from that month warned that:

> A tax increase, however, almost certainly would slow economic growth and could lead to a recession. This would mean less revenues for the federal government and a higher budget deficit...Advocates of higher taxes often overlook the most probable result of their policy: An economic slowdown or a recession...Even if a tax increase results in only slightly less economic growth, the budget deficit could rise rather than fall.[2]

Repeated Warnings. As the budget negotiations progressed, a marathon process which by itself weakened the economy by undermining investors' optimism and reducing consumer confidence, legislators repeatedly were warned that higher taxes would slow economic growth. Once the basic framework of the budget agreement was revealed, condemnation from economists was even more pronounced. The Deputy Chief Economist from the United States Chamber of Commerce, Lawrence A. Hunter, wrote:

> It would be self-defeating to increase taxes now. Never in the history of modern capitalism has a tax increase pulled an economy out of recession. Indeed, just the opposite is true. Higher taxes reduce incentives and punish productive activity, which slow or even reduce output. Raising taxes now only would ensure a deficit-increasing recession of far greater magnitude.[3]

Other economists were equally critical, noting, "[the budget agreement] all but guarantees that the final budget legislation will mean the end of the economic growth America has enjoyed since the early 1980s."[4] Lawrence Kudlow, Chief Economist at the Wall Street firm of Bear Stearns and former Chief Economist at the Office of Management and Budget under Reagan, cautioned, "You just don't embark on a large tax increase in a recessionary setting....I don't see how the President and Congressional leaders can get up and talk

---

2 Daniel J. Mitchell, "Mr. President, Keep Your Promise: No New Taxes," Heritage Foundation *Backgrounder* No. 769, May 18, 1990.

3 Lawrence A. Hunter, "Would tax-budget accord do more harm than good?" *The San Diego Union*, October 7, 1990.

4 Daniel J. Mitchell, "The New Budget Agreement: Part I, From Bad to Worse," Heritage Foundation *Executive Memorandum* No. 289, October 9, 1990.

proudly about austerity and pain because that is not leadership and that will not help the economy."[5] Norman Ture, President of the Institute for Research on the Economics of Taxation and former Undersecretary of the Treasury during the Reagan Administration, urged, "The President should tell us how a whopping tax increase and virtually no cuts in spending other than in defense outlays will help the U.S. economy to grow."[6]

Disproportionate Harm. There also were warnings that a tax hike especially would harm minorities. In October of last year, the U.S. Civil Rights Commission noted that blacks and Hispanics disproportionately suffer when unemployment rises. In good economic times, by contrast, barriers to minority employment and upward mobility break down as employers compete for much needed workers. Commission member Russell G. Redenbaugh aptly noted that "To raise taxes when an economy is already weak and in a recession is like throwing a drowning man a rock." He was right. Opportunities for blacks and Hispanics have been shrinking in the past year, after expanding dramatically in the 1980s.

Opponents of the budget deal in both the House and the Senate, led by Texas Representative Tom DeLay and Wyoming Senator Malcolm Wallop, both Republicans, also notified their colleagues that raising taxes would usher in a recession. By the time the final budget deal was voted on in late October last year, neither the President nor any member of Congress honestly could deny having been warned about the impact a record tax increase would have upon the economy.

Legislators supporting tax cuts today also should be asked why it has taken so long for them acknowledge the disastrous consequences of last year's budget deal. Lawmakers such as Wallop and DeLay, as well as New York Senator Daniel Patrick Moynihan and South Carolina Representative Robin Tallon, both Democrats, deserve credit for introducing tax cut proposals very early in the year. Had their colleagues acted quickly, and supported these measures, the recession might very well have been over by now.

By squandering opportunities to reduce the tax burden earlier in the year, recent converts to the cause of lower taxes bear some responsibility for the additional unemployment and economic decline that has plagued the economy throughout the year. Some of these lawmakers may argue that they thought the economy was about to recover without a growth package. If so, then they once again listened to the wrong advice. Early in the year, policy makers were told:

> America's largest-ever tax increase, enacted last year, was supposed to reduce the budget deficit and strengthen the economy. Instead, it is proving an economic disaster....This recession, like most others, is the result of high taxes....The way to end the recession is to reverse the mistakes that caused it...The Wallop/DeLay-Tallon bill [payroll tax cuts, capital gains tax cut, IRAs, and lower taxes on business investment] is a good start for policy makers interested in restoring prosperity and creating jobs.[7]

Options Available. The Wallop-DeLay-Tallon "Economic Growth and Jobs Creation Act of 1991" (S. 381, H.R. 960) was introduced in February of this year. It quickly won endorsement as an anti-recession measure by leading business and taxpayer organizations, including the U.S. Chamber of Commerce, the National Federation of Independent Business, the American Farm Bureau Federation, Citizens for a Sound Economy, Citizens Against Government Waste, and the U.S. Business and Industrial Council. Lawmakers clearly were informed that options were available to minimize the suffering imposed by the recession; they simply chose to ignore those options. Those not ignoring the suffering have been Senator Robert Kasten of

---

5 "The Budget Summit Agreement: Part VII, Economists Speak Out," Heritage Foundation *Executive Memorandum* No. 286, October 3, 1991.

6 *Ibid.*

7 Daniel J. Mitchell, "A Proven Formula to Restore Economic Growth," Heritage Foundation *Executive Memorandum* No. 295, February 13, 1991.

Wisconsin and Representative Vin Weber of Minnesota, both Republicans, who are pushing a broad tax relief measure.

Opposing the Wallop-DeLay-Tallon effort to end the recession was the White House, led by Budget Director Darman and Treasury Secretary Brady. They mysteriously continue to echo Herbert Hoover's platitudes of the early 1930s, when America was racing downhill into depression. To Darman, Brady, and their colleagues, prosperity is always around the next corner. They insist that there is nothing that Washington can do to get America working again, except perhaps for the Federal Reserve Board to print more money. Yet it is Washington's tax-and-spend binge that hurtled America into its recession. A return to 1970s-style monetary policy only will exacerbate the economy's problems. Darman and Brady nonetheless seem determined to keep the White House opposed to tax reduction, regardless of the political and economic consequences. Furthermore, despite strong support for significant tax and spending cuts from members of both parties on Capitol Hill, opposition from congressional leaders in both parties is stymieing development of a consensus growth package. Ironically, the politicians who now are using their powers to block legislation that would put Americans back to work are the very ones who played a pivotal role in imposing last year's tax increase on the economy.

Admitting the Mistake. With any luck, the message of this week's elections and the growing support for tax cuts among rank and file members of Congress will be an alarm for the Bush Administration and entrenched congressional leadership that it is time to "wake up and smell the recession." Washington's belated recognition that the 1990 budget agreement backfired is little solace to those suffering from the recession's effect. The economic downturn afflicting America need not have occurred. Nor is its lengthy duration necessary. The recession itself was caused by policy mistakes, including higher taxes and sweeping new economic regulations; the downturn's long duration is the result of political inaction and failure to reverse these policies. At last, perhaps, Washington will admit its mistake and take the measures that will allow the American economy to start growing again.

Daniel J. Mitchell
John M. Olin Senior Fellow